









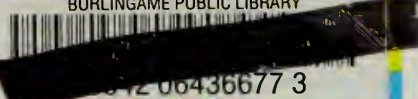
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WE BROWSE THE COMPANIES

# BusinessWeek

## FISH TALE



THE BIZ THAT'S GETTING AWAY

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SEPTEMBER 4, 2006 [www.businessweek.com](http://www.businessweek.com)

## Revealed! SECRETS OF THE MALE SHOPPER



✓ HIS REAL IDENTITY

✓ LOOK WHAT HE'S BUYING!

✓ WHY MARKETERS WANT HIM

HOW  
WE  
FOUND  
OUT!

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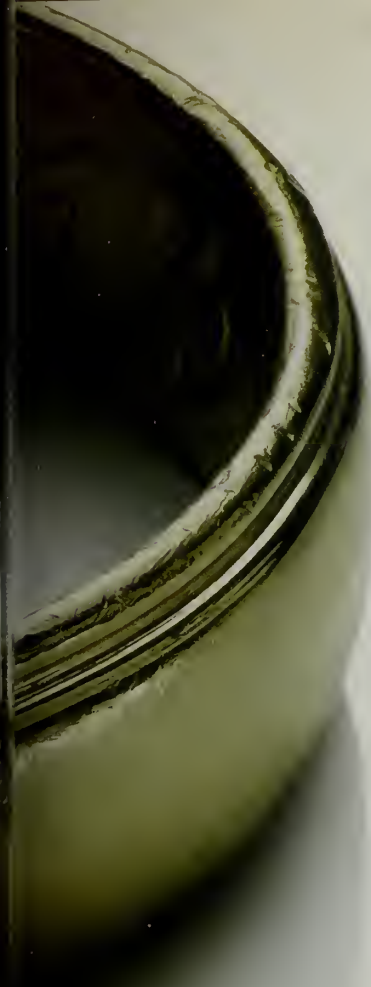
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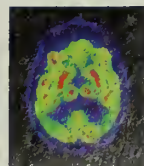






## What will we remember after Alzheimer's is long forgotten?

Imagine Alzheimer's itself has become a hazy memory. GE is working to develop visionary solutions that could help predict and track the progression of the disease today, so one day it might be eliminated altogether. The future's promise has never been clearer. When you re-imagine healthcare, you re-ignite hope.



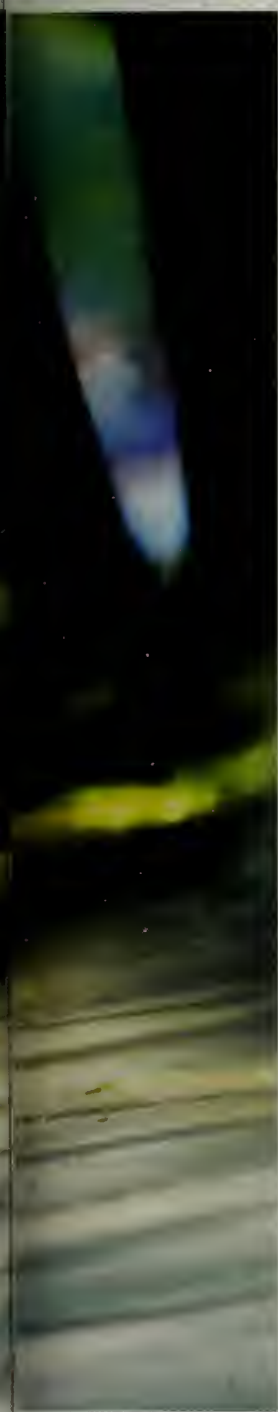
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## Nightmare on Wall Street

Over the past two years, private-equity firms have poured some \$5 billion into Hollywood—but the returns are for the most part pretty measly

## The Hot Ticket Isn't Ticketmaster

The giant is taking aim at increasingly popular Web resellers like eBay and Amazon

## Global Business

### Fashion Conquistador

Cheap-chic fashion chain Zara has transformed itself into Europe's leading apparel retailer. Now it's aiming to revitalize growth in the U.S. and Asia

### India: Soda Makers on the Rocks

Tests against Coke and Pepsi by critics and environmentalists cite toxins—but sound like xenophobia

### SEE GLOBAL COVERAGE:

For additional insights into European and Asian business, please go to [www.businessweek.com/globalbiz](http://www.businessweek.com/globalbiz)

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### Troubled Waters

The U.S. fishing industry is in deep trouble. Catches are falling. Imports are rising. And the list of overfished species remains long despite ever-tightening rules. Could a market-based system for parceling out individual property rights to fish in the sea be the industry's salvation?

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Private online communities are providing special insights into consumers' needs

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### Banking on Brands

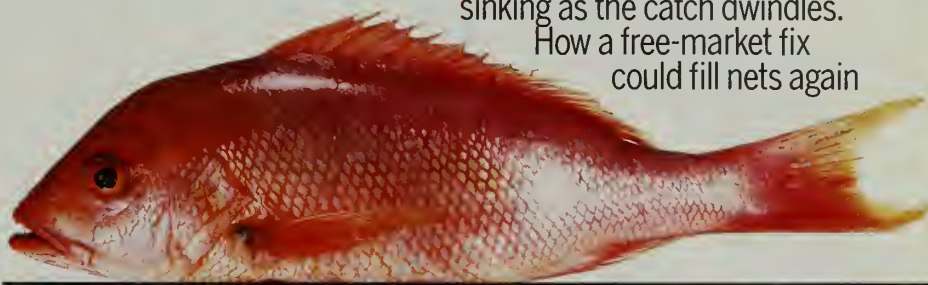
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Have you ever wished there were a better way to predict earnings prices, or the potential success of new products? About two dozen companies, including Yahoo, Microsoft, and Google are testing out **a new forecasting method** that relies on the collective knowledge of the people closest to the details—employees. This month's *CI* Guide to Technology looks at these so-called **prediction markets**, which work much like stock markets except that people use play money to wager on everything from future sales to new product launch dates. Find out how movie studios are using one prediction market, **the Hollywood Stock Exchange**, to forecast box office revenue and craft marketing plans. To determine if a prediction market could be right for your company, listen to a **podcast interview** with pioneer Robin Hanson, a professor at George Mason University. When you're ready to take the plunge there's a Tip Sheet with the do's and don'ts to help get started. And **take our quiz** to see if you've got what it takes to forecast global current events. To find all this and more go to [www.businessweek.com/go/06prediction](http://www.businessweek.com/go/06prediction)

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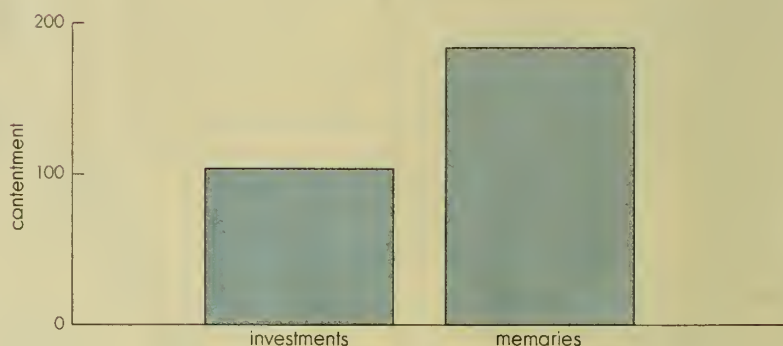
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## CONTENTMENT INDEX

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# JP Front

**"Quattrone was a very big fish, but the evidence against him was not very good."**

—John Fahy, a former federal prosecutor in New Jersey, on former investment banker Frank Quattrone's deal with prosecutors allowing him to avoid a third trial and return to business, as reported by Bloomberg News

EDITED BY DEBORAH STEAD

## LEWIND A STOCK COARS ON HIGH ANXIETY

**AVY DEMAND** for security technology drove American Science & Engineering to No. 12 on *BusinessWeek*'s Best Hot Growth ranking of 10 small companies earlier this year (BW—page 5). But on Aug. 9 the stock fell 21%, to \$30 a share. Now AS&E's fortunes have changed again literally overnight. On Aug. 10, British authorities announced they had thwarted an alleged terrorist plot to blow up airplanes by ing explosives hidden in sports drinks. AS&E makes X-



AMERICAN SCIENCE & ENGINEERING  
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ray systems for screening cargo, vehicles, luggage, and even people. And unlike standard metal detectors used in airports, its system can spot liquids. It therefore could be used to nab anyone attempting to sneak them onto planes. The U.S. Homeland Security Dept.'s Transportation Security Administration is planning to test AS&E's people-screening systems in airports.

The company's stock flew to 47.20 on news of the terrorist plot, marking a full recovery from its earnings-related swoon. It could take several months for AS&E's top line to reflect the impact of all this. But, says Bob Postle, the company's vice-president for sales and marketing, "we've certainly had an increase in phone calls."

—Arlene Weintraub



## HOMEBUILDERS

### Dear Ben, Feel Our Pain

**WITH HOUSING SLUMPING** dramatically, hopes for a soft landing in the sector could be evaporating. According to **Goldman Sachs**, housing inventories are at their highest levels in more than a decade. Just how worried are homebuilders? A few weeks ago, on the eve of the Federal Reserve Board's Aug. 8 Open Market Committee meeting, the **National Association of Homebuilders** sent letters to **Fed Chief Ben Bernanke** and each of the other members of the interest-rate-setting committee. The message: Official stats don't capture how badly housing is hurting, since those figures don't include canceled contracts, which doubled over the past year. The letter also argued that inflation is more benign than feared, because one measure, rising rents, is overweighted in the consumer price index. NAHB Chief Economist David Seiders says this is the first time since he joined the staff, in 1984, that the group has written such a letter to the Fed.

Granted, such a move seems mild compared with the actions of the early 1980s, when, to protest double-digit interest rates, a desperate NAHB mailed lumber (two-by-fours, meant to symbolize unbuilt homes) to then Fed Chief Paul Volcker. And it's not known if the NAHB's recent letter influenced the bankers in the marble temple, who chose—for the first time in two years—not to raise rates at its August meeting. But, says Tom Schlesinger, director of the Financial Markets Center, a Fed watchdog group, the urgent communication is "certainly a symptom" of the current anxiety.

—Catherine Yang

## VERBATIM

### 'SHOP IN THRIFT STORES' (TIP NO. 39)

From "101 Ways to Save Money," sent by Northwest Airlines to a number of employees coping with steep pay cuts and layoffs as part of the airline's plan to emerge from Chapter 11.

8. Replace 100 watt bulbs with 60 watt.
15. Get hand-me-down clothes and toys for your kids from family and friends.
18. Take a shorter shower.
21. Make your own baby food.
34. Change the oil in your car yourself regularly.
46. Don't be shy about pulling something you like out of the trash.







## CITINGS

### KICKING WIKI OUT OF THE PATENT OFFICE

**PATENTS** are enduring, conferring rights on their owners for up to 20 years. Yet until about a week ago, scores of them may have been granted based partly on information that can be altered with a keystroke from anyone surfing the Web.

On Aug. 15, the U.S. Patent & Trademark Office yanked Wikipedia from the digital toolbox its examiners use to help determine a patent application's validity. But over the past several years, examiners used the online encyclopedia, which allows users to edit entries, to inform their decisions. Wikipedia has



been cited in patent decisions on everything from car parts to chip designs.

"The problem with Wikipedia is that it's constantly changing," Patents Commissioner John Doll said. "We've taken Wikipedia off our list of accepted sources of information." An agency spokesperson said inquiries

from *BusinessWeek* about the use of Wikipedia led to the policy shift.

Critics say the change is long overdue. "I've been complaining about this for years," says Greg Aharonian, publisher of a patent newsletter and a longtime agency gadfly. "From a legal point of view, a

Wiki citation is toilet paper." Doll says the agency used Wikipedia entries as background and not as a basis for accepting or rejecting an application.

—Lorraine Woellert

## TWO-MINUTE WARNING

**THE NFL ALMOST FUMBLLED** this one. Less than a month before the start of the regular season on Sept. 7, it realized that its Wilson footballs, signed by retiring Commissioner Paul Tagliabue and still in production, were soon to be obsolete. It was until Aug. 10, two days after Roger Goodell was named to the post, that Wilson Sporting Goods began to crank out Goodell-signed pigskins at its Ada (Ohio) plant, which will work overtime to make the 9,000 used in a season. Chris Considine, Wilson's president, says the factory lifted Goodell's signature from the contract he signed with Wilson as the NFL's COO. As for the 5,000 Tagliabue balls ready to go, the league will eat the costs (about \$250,000) and donate them to high schools.

—Tom Low

## BLOGSPOTTING

### MUSINGS OF AN ADMAN

[russelldavies.typepad.com/](http://russelldavies.typepad.com/)

» **WHY READ IT** Advertising account planners—the folks who interpret customer research and make sure the creative types are lined up with client strategies—can learn from a master, Russell Davies, who gives “homework” assignments on this blog. For those outside advertising, this former head of planning at Nike and ad shop Wieden+Kennedy has something for everyone: snapshots of ads and images that inspire him, theories about brand authenticity, and, it must be said, some really cute pictures of his son, Arthur. —Jena McGregor

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## TRADE TALK

### 'UNCLE SAM OR UNCLE SUCKER?'

Stock up on red chili peppers and buy that granite counter-top now: **Chuck Grassley**, Senate Finance Committee chief, wants to stop U.S. tariff breaks to India (chilies) and Brazil (a granite exporter). Grassley (R-Iowa), who blames the countries for stalling the recent Doha trade talks, says that unless the White House ends preferential treatment for the two nations, he will block renewal of the \$1 billion, 140-country program that makes some imports from



developing nations duty free. "Are we Uncle Sam or Uncle Sucker?" he asks.

The U.S. Trade Representative's Office is reviewing the program, with comments due Sept. 5. It may get an earful about some unintended consequences of Grassley's plan. McCormick & Co. gets 80% of its chili peppers from India, and U.S. jewelers sell India's diamond rings. Importers of auto parts from Brazil may be hit harder: It's tough to find suppliers of these highly engineered items, says the Motor & Equipment Manufacturers Assn. —Catherine Yang

## EAU DU JOUR

### THE SWEET SMELL OF EXCESS

**PERHAPS THE** fragrance industry's next scent should be called Proliferation. Trying to hang on to market share as industry growth flattens, makers are introducing scent after scent. "It's a challenging and extremely competitive time," says Karen Grant, a senior beauty analyst at market research firm **NPD Group**. Last year a record 124 new perfumes and colognes hit U.S. department stores. That figure, which doesn't include "mass" fragrances sold at stores like **CVS** and **Target**, tops the number of so-called prestige scents launched during the 1970s and 1980s.

This year is expected to be even more prolific. About 200

prestige fragrances should be launched by yearend, including brands from celebrities (Derek Jeter's Driven, for instance), TV shows (*Desperate Housewives'* Forbidden Fruit), and clothing lines (Juicy Couture, from the fashion brand of the



same name).

Grant says the profusion of scents started in 2002, in the post-9/11 economic downturn. Since then fragrance growth has been minimal, despite successes like Britney Spears's Curio which racked up \$125 million in global sales in 2004 and 2005, according to Euromonitor. This year, Grant predicts, the almost billion prestige market will stay flat or rise just 1%.

The flood of products means that most scents have a shorter life cycle—a year, most, vs. about three years the past, says Micheline Jordaan, Divisional Merchandise Manager of Fragrance for **Macy's East**. Bernd Beetz, CEO of **COTY** however, appears to shrug such worries. He compares the turnover to fashion's space: "Are there too many fragrances on the market?" he says. "That's like asking 'Do you ever have enough clothes?'" —Elizabeth W.

## WIRELESS WORLD

### JUICING UP THE BLACKBERRY

**GOT YOUR BELT CLIP** handy? **Research In Motion** is preparing to launch the latest BlackBerry, the Pearl, that should appeal to more than just harried executives. In a revamp of its business model, the Waterloo (Ont.) company and wireless carrier **T-Mobile** will pitch the device to regular, gadget-loving consumers starting in mid-September. About the same size as Motorola's popular Razr phone, the Pearl will have a built-in digital camera, Bluetooth wireless capability,

and a memory-card expansion slot to handle music and video.

Now that even soccer moms are managing their lives by mobile e-mail and text messaging, wireless carriers have been pushing RIM to create more consumer-friendly products. And they seem to be happy with RIM's effort. **Cingular Wireless** is expected to add the BlackBerry Pearl to its lineup this fall. Other carriers are testing it, too.

RIM is jumping into a crowded market dominated by **Nokia**, **Motorola**, **Samsung**, and others—but it has no choice. Since January, its

market share of corporate mail activations slipped five percentage points, to 59% a market that's still growing, says researcher Strategy Analytics.

There is a risk that RIM move will turn off its most important customers, corporations that treasure BlackBerry because it is more

secure than other wireless e-mail systems. That's precisely because RIM hasn't permitted expansion slots, camera and other popular features. —Roger O. Crockett





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“After reading about how [Coke’s] Mary Minnick treats those she works with, I went out and bought a case of Diet Pepsi.”

—Tom Sadlowski  
 The Woodlands, Tex.



### INSIGHTS AND ADMONISHMENTS FOR COKE'S MARY MINNICK

DEAN FOUST'S "QUEEN OF POP" (Cover Story, Aug. 7) gave insightful analysis of Mary Minnick's innovative and creative approach to reinvigorating Coca-Cola Co. However, one statement does not accurately capture the essence of her approach: that Minnick's exploration of new products as far afield as beauty and health care "would have been heresy to legendary ex-Chief Executive Roberto Goizueta."

When Goizueta became Coke's CEO in 1981, he took over an underperforming company that over the years had diversified into unrelated businesses ranging from water purification to shrimp farming in an attempt to grow. One of his first initiatives was to analyze Coke's various businesses using "economic profit" (net operating earnings minus a capital charge for net assets employed). A business with positive economic profit that increases over time creates shareholder value. This analysis concluded that only Coke's core carbonated beverage business was creating shareholder value. The other far-flung businesses, while generating revenue, were consuming value. Consequently, they were divested or shut down. Goizueta then focused on Coke's core

beverage business using its substantial competitive advantages: global brand, worldwide distribution system, and sales and marketing expertise. The results of his 18-year tenure are history, and we have a good history at that.

Minnick's new broadening initiative also focuses on Coke's competitive advantages: brand, worldwide distribution system, and ability to meet consumer beverage needs. The health-care and beauty products being explored are beverage products, not totally unrelated. If Minnick's new initiatives have business plans that generate positive economic profit that grows over time and are executed successfully so that growth in economic profit is realized, her actions are not "heresy" but are following in the footsteps of one of the greatest CEOs of the past 30 years.

—Jan Sha  
 Senior Partner  
 Shack & Tulloch LLP  
 Fairport, N.Y.

I, FOR ONE, am tired of rewarding "discontented" managers with success. After reading about how Mary Minnick treats those she works with, I went out and bought a case of Diet Pepsi. Let me

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unt, Mary: You alienate consumers as well as co-workers.

—Tom Sadlowski  
The Woodlands, Tex.

## HY "TOM" IN BANGALORE AS TROUBLE RELATING

HAVING JUST spent two weeks in call-center hell trying to restore my EarthLink DSL service along with Verizon phone service, I was stupefied as to why it was so difficult to fix what seemingly was a "local" problem ("Call center? That's so local," Global Business, Aug. 7). To operations vice-presidents across the country: please recognize that your consumers aren't idiots. I found it particularly amusing, when on my fourth or fifth call, the operator clearly was instructed to "disinfect" this international business model by using Anglo names like Tom and Jack. Better work on the language skills a bit, st. It's especially insulting when you sit on hold for over 15 minutes listening to: "Your call is very important to us," only to speak to someone who really doesn't have any stake in fixing the problem. And you wonder why we get irate? There are plenty of Americans who used to do these jobs, many in our backyards, who do have a stake in good customer service.

—Lisa W. Parker  
Principal  
Stratovation Consulting Inc.  
Marblehead, Mass.

## NO OF THE RUTS M SEEMS TO BE STUCK IN

HAD TO LAUGH at the practice of Friday knock meetings" at General Motors Corp. ("Renault-Nissan: Say hello to Bo," The Corporation, July 31). Knocking on tables to approve a buyer's pitch is a revealing tidbit about the outdated business culture at "Generous Motors" and says a lot about what is wrong with the company. Automotive suppliers are tired of the brutal tactics of GM and like companies. The fact is that GM is on the decline, and its supplier base will gain more leverage than ever before. Bo I. Andersson appears to have good ideas about increasing the number of shared components among GM vehicles. However, I suspect that he will resort to the short-term tactic of his predecessors—to unilaterally reduce the purchase price of components and raw materials at the expense of suppliers' margins (and possibly their solvency).

Many automotive suppliers are stretched to their limits dealing with rising material costs. I believe that rather than people thinking Andersson is a hero in five years, he will be remem-

bered as "that head purchasing guy who helped usher GM into bankruptcy."

—Jeff Stout  
Baraboo, Wis.

Editor's note: The writer works in the plastic molding industry, providing components to automotive original equipment manufacturers and their suppliers.

RE "CAN GM rev up its hip factor?" (Up Front, Aug. 7): General Motors has a very long history of designing and offering lousy "import-beaters" such as the Chevy Scooter, Vega, Nova, and the super-sad Cavalier, the ill-fated Cadillac Cimarron, and Pontiac Sunfire. Now we have a new gang of small cars from Honda, Toyota, and Nissan, some of which have been marketed very successfully in Japan and Europe for three or more years. These are shrunken bigger cars with most of the popular features standard, clearly not built for price alone. For the most part, they are all winners.

The Chevy Aveo in your article is a cheapo Korean-made car that rates right down at the bottom of most lists in just about all ways, clearly very seriously compromised by GM to maximize profits. Until GM ceases and desists with this practice, it will continue to lose market share, total sales, and eventually pass the point of recovery.

—Bruce W. Parkinson  
San Jose, Calif.

## MILITARY SPENDING: CAN THE MARKET CURB THE WASTE?

RE "WHEN OUTSOURCING turns outrageous" (Government, July 31): It's unfortunate that Senator Byron Dorgan's (D-N.D.) bill "eliminating fraud and abuse and improving competition in contracting and procurement" failed to clear the Senate. Perhaps the market itself will do what our elected representatives have failed to do: provide oversight of the vast amount of tax dollars doled out by the Pentagon to military contractors. Boeing Co.'s recent settlement with the Justice Dept. resulted in sharp losses for the second quarter, calling into question its current and future earnings capacity. A bipartisan group of senators has called for a hearing on Boeing's many procurement scandals. As taxpayers, we should support the call for this hearing as well as a reevaluation of government spending practices and increased accountability at the highest levels of the Pentagon.

Honest bipartisan congressional oversight can bring the military-industrial-congressional complex to heel and thus make a tiny slice of the Pentagon's budget available to provide health care for our

children who lack it, hire cargo inspectors for our insecure ports, rebuild our public schools, and much more.

—Vice-Admiral Jack Shanahan  
(U.S. Navy, Ret.)  
Ormond Beach, Fla.

## DRIVERS AREN'T THE ONLY REASON AMERICA'S ADDICTED TO OIL

LET'S STOP BLAMING consumers alone for the gas problem ("Can't stop guzzling," News: Analysis & Commentary, July 31). This problem is the result of a fat and happy generation of politicians, business leaders, and consumers that forgot about the oil crisis of the '70s. What are the real alternatives? With little or no mass transit system in 99% of the country, Americans are forced to commute via automobile. Carpooling is only valid for those who have the single agenda of commuting to work—no picking up dry cleaning, dinner, or kids at soccer practice. And the transaction costs of selling and buying a new fuel-efficient vehicle make gas savings negligible. This is the old principle of inelastic price demand at its best. It's just too bad we didn't "get it" 30 years ago.

—Christian Carr  
Baltimore

## CORRECTIONS & CLARIFICATIONS

In "An ugly duckling finds its wings" (July 31, 2006), we described Embraer as the world's third-largest aircraft maker. The company is the No. 3 commercial jet manufacturer, but is No. 4 behind Canada's Bombardier when executive jets are included.

In our Aug. 14 cover story on Digg.com, we incorrectly described the offices of the San Francisco Bay Guardian as grungy. We regret the error.

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# Brainier Robots, Brainier Kids?

When I was a kid, a favorite pastime was building things with my Erector set. In the 1980s my own kids satisfied the urge to build and tinker by programming Apple II computers. Sadly, both mechanical construction sets and computers that kids can program have all but disappeared. But now LEGO Mindstorms offers a worthy, if expensive, replacement.

LEGO Mindstorms NXT (\$250) is a significant improvement on the original 1998 Mindstorms Robotics Invention System, and like its predecessor is a collaboration between the Danish toymaker and the MIT Media Lab. A more powerful computer brain lets the new robots run longer, more complex programs that incorporate inputs from up to four sensors. And using the rods and beams of LEGO Technic construction kits instead of the LEGO bricks of the original makes for more interesting designs. You hook the small, programmable computer, the NXT controller, up to sensors that can detect light, sound, touch, and, through ultrasound, the presence of nearby objects. The NXT uses those sensors to control up to three servo motors, whose output shafts can rotate in precise 45-degree increments.

Sounds simple enough. But building robots requires manual dexterity and patience, a trait few children possess in abundance. Creating the suggested first project, a robotic vehicle that demonstrates all of the sensors, took me a good deal longer than the promised 30 minutes, even after I had sorted the myriad fiddly bits into plastic containers. LEGO recommends the kit for children as young as eight, but I suspect those younger than 12 will require a fair amount of adult help in assembling the models.

**WHILE YOUNGER CHILDREN** may find the actual construction somewhat frustrating, I imagine people of all ages will be fascinated by programming and running the robots. Though the instructions can be entered on the NXT box, it's clumsy—the screen is small and dim and has no mouse or keyboard—and not really suitable for anything but very simple maneuvers. Nearly everyone will choose, instead, to install accompanying software on a PC or a Mac. You can then create programs and download them to the NXT using a USB cable (which LEGO supplies) or Bluetooth wireless.

Once you have built your robot, you write programs by arranging icons on a computer display. To create motion you select a motor-control symbol and choose the settings: which motor or motors should turn on, if they should run forward or backward, and for how long. To get the sensors on the robot



LEGO  
MINDSTORMS  
ROBOT

working, you drag in the appropriate sensor icon, then set the sensitivity level and the action to be taken when it is triggered. With two motion icons and one touch-sensor icon, for example, you could program a robot to move forward until it hits something, then move backward for five seconds. Of course, more complex behaviors can be created, and much of the fun comes with tweaking the programs just to see what happens.

With the original Robotics Invention System, LEGO was surprised when many early users turned out to be adults, especially engineers buying kits for themselves. This time they're prepared, offering advanced programmers a software development kit for more sophisticated work.

## LEGO's robot kit could help spark an early interest in science

programming contributes to interest in engineering and science, but I can't help but believe it does. Today's leading high-tech toys are video games, which mostly give children vicarious training in handling automatic weapons. LEGO Mindstorms NXT could be a helpful antidote. ■

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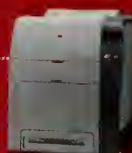
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## The Accidental Ad Agency

**Flavorpill is additional proof** that you can build a Web media company from an e-mail. Yes, just like online classifieds juggernaut craigslist, whose genesis was an e-mailed list of parties in San Francisco. And DailyCandy, which now directs style-savvy young women in 10 cities to all manner of boutiques and services, and, which, earlier this year, projected

60%-plus profit margins on revenues of \$18.8 million in 2006.

Flavorpill was once a list of cultural events that co-founders Sascha Lewis and Mark Mangan sent out to a few pals in New York. It's now an e-mail that goes out to a few hundred thousand subscribers in four U.S. cities and London. It owns five other Web properties, including music site Earplug and art site Artkrush. What DailyCandy is to fashion, Flavorpill is to the subset of urban culture—DJ appearances, gallery openings, film revivals—often tagged as “downtown.” It's a cultural signifier that the recorded voice greeting callers to Flavorpill's Manhattan offices is breathy, British, female, and young, as it is at another New York-based hipster media play, Vice.

Flavorpill employs just 10 full-time. Revenues this year, insiders say, will be around \$3.5 million. Like other smallish players in this space, it's becoming adept out of necessity at building bridges between its sensibilities and those of big mainstream advertisers. For Anheuser-Busch's Budweiser Select brand, Flavorpill chose 10 artists to design ads for its own Web sites. But the beer baron ended up liking these ads so much that it ran them in music magazine *The Fader*. And once Web visitors vote on their favorites later this year, one artist's ads will appear in an multi-city outdoor campaign next year. Thus a small media company started out selling its audience and cool quotient, which is old news, but ended up designing ads that will run more widely, which is new. Flavorpill's moves describe a fresh reality of marketing: The line between which entity creates media and which creates advertising is suddenly and strangely malleable.

**IT IS, OF COURSE,** very Old Media of me to try to slot Flavorpill exclusively into a category marked “media company” or “creative agency.” “One of the goals,” says Lewis, is “to create as close as possible a seamless relationship between the media partner, aka the advertiser, and our content and our product.” The Web “has created a [more] collaborative effort between the media vehicle and the creative content... than any medium in the past,” says Tony Ponturo, vice-president of



CO-FOUNDERS LEWIS AND MANGAN

**Flavorpill was just a Web content player. But Bud had a better idea**

*York Times Magazine*, who has written extensively about the changing dance between underground culture and the mass market. “Flavorpill has figured out they know some stuff that big companies want to know.” And, given Flavorpill's newness and how it's unencumbered by traditional media mores, “it doesn't hurt Flavorpill's brand in any way.” Two more deals like Select and Flavorpill practically doubles in size. And so Lewis, who just six years ago merely e-mailed pals about musical events, sounds like his company has a whole new *raison d'être*. For the new guys, it's not much to turn an editorial sensibility into one that works as advertising. ■

global media and sports marketing for Anheuser-Busch. He confirms that Anheuser-Busch expects to double its online spending next year, to around 10% of its ad budget. (Not that the Flavorpill deal will eat up much of it. What the companies call Select Flavor adds up to under \$1 million, or a rounding error for Anheuser-Busch, which in 2005 shelled out \$785 million in media spending.)

Select Flavor's ads, up at [www.flavorpill.net/select](http://www.flavorpill.net/select), are augmented the “product seeding” among the urban cool set that's de rigueur for such deals

these days. (In July, Flavorpill ) on a party in New York celebrating the publication of Chris Anderson's book, *The Long Tail*, and served Select to celebrants.) But getting Select the hands and heads of this mix is exactly why Anheuser-Busch tapped Flavorpill in the first place. “A company like Flavorpill is a marketing company at all, but they have the right sort of frier says Rob Walker, author of the “Consumed” column in *The N*

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BY JAMES C. COOPER

# Housing: The Roof Won't Collapse on the Economy

As builders adjust their inventories, other sectors will offer plenty of support

**U.S. ECONOMY** It seems to be a foregone conclusion: The economy is slowing, perhaps sharply, as some pundits argue. Bond investors, at least, have taken the bait. Bond demand has surged, sending yields downward in recent weeks on the belief a softer economy will cool off inflation and allow the Federal Reserve to keep pressing the pause

button on interest rates. The market for interest rate futures is even starting to build in an expectation that the Fed will start to cut rates early next year. July weakness in housing and some favorable-looking price indexes only support the slowdown scenario. Right?

Not so fast. Take a look at some of the economic readings outside of housing. Industrial production in July continued to gain momentum, not lose it, and the operating rate for all industry hit a six-year high. Consumers responded to sweet deals on autos in July, even as they boosted their spending on other retail items. Foreign demand also remained strong, as June exports posted another big gain. And second-quarter profits of companies in the Standard & Poor's 500-stock index picked up a solid advance of nearly 13% from a year ago, even excluding the energy sector. These reports hardly point to a broad moderation in economic activity.

All of this is not to downplay what is essentially a recession in housing. Housing starts sank further in July. Permits to begin new construction plunged close to a four-year low (chart), and an industry measure of builders' sentiment sank to a 15-year low. Forward-looking indicators from declining mortgage applications to depressed attitudes of potential home buyers to moribund buyer traffic in model homes indicate more weakness to come. But as the numbers so far suggest, weak housing does not necessarily mean a soft economy.

**RIGHT NOW, EVEN** a passel of strong data cannot draw attention away from the weakness in housing, the economy's most visible and most vulnerable sector. The worry is the housing slump, which appears to be getting worse, will drag down the entire economy.

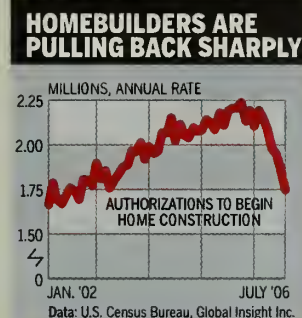
However, this housing cycle is different. In the past, housing downturns have been the result of high interest rates and broad economic weakness leading to rising unemployment. This time, housing is going through its own cycle, largely independent of wider economic conditions. The economy outside of housing remains solid: Unemployment is low, household incomes are growing, and 30-year fixed mortgage rates, at a bit over 5% in mid-August, are hardly onerous.

This housing recession is primarily an inventory

correction, as builders adjust to the aftermath of the demand frenzy in previous years. This is squeezing prices of new homes, with attendant effects on existing home prices. However, the sharp drop in housing starts of more than 20% so far from the January peak implies builders are moving quickly to realign their stocks of unsold properties with the lower level of demand. The faster the

adjustment takes place, the quicker the downward pressure on home prices will ease.

The Federal Reserve seems particularly sensitive to the housing downturn but believes the realignment will not cripple the economy. Indeed, data at the start of the third quarter suggest that key areas that showed substantial



slowdowns in the second quarter, including consumer spending and business outlays for new equipment, are rebounding this quarter.

**START WITH CONSUMERS.** Retail sales in July jumped 1.4% from June, the best showing in six months. Even excluding the boost from auto sales, which hit a 17.2 million annual rate, up from 16.3 million in the second quarter, retail sales still rose a hefty 1%. And it wasn't just higher gas prices pushing up receipts at the pump. Sales of clothing and electronics were strong, as were catalogue and Internet sales.

One interesting point is that the housing downturn has not been accompanied by weakness in retail sales of home-related items. So far this year, sales at furniture and appliance stores have grown 13.1%, measured at an annual rate, and purchases at stores selling electronics and appliances are rising at an 11.6% rate. Both growth rates are more than double those for all of 2005. Moreover, sales at building materials and garden equipment stores are up 9.4%, only a bit below last year's 10.3%.

The retail performance puts overall consumer



spending on a high level compared with the second quarter (chart). It also hints at a greater contribution by households to economic growth this quarter compared with the modest 2.5% annual rate of increase in second-quarter spending. Of course, one month doesn't make a quarter, and household sentiment nose-dived in August amid the Israeli-Hezbollah conflict and a foiled terrorist plot in Britain.

However, as it has been true throughout this expansion, consumers don't always act the way they say they feel. The biggest reason is purchasing power: In the past year, workers' incomes from wages and salaries are up 6.8%, the fastest annual advance in 5½ years and more rapid than the 4% increase in overall consumer prices. In the aggregate, household budgets have been squeezed by costlier energy, but as they showed in July, consumers still have some room to maneuver.

**ANOTHER SECTOR** offering signs of rebounding this quarter is business outlays for new equipment. The July report on industrial production showed manufacturing output rose a tepid 0.1% from June, but the softness fully reflected a steep 5.4% drop in auto production. Excluding automakers, factory output jumped 0.7%, led by a big gain in business equipment. For example, production of industrial machinery rose 1.9% from June, while high-tech gear, including computers, telecom hardware, and semiconductors, increased 1.2%.

Strong foreign demand for capital goods and other items is also powering gains in manufacturing. Export

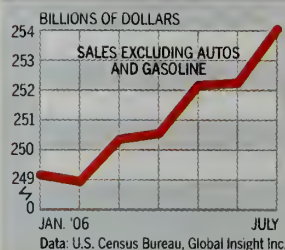
growth has been robust this year, especially from Asia. Adjusted for prices, exports of goods are up 11.4% in the past year, twice the increase in imports, and through July the growth rate in recent months has been even faster.

Meanwhile, businesses are shelling out big sums for new factories, offices, and warehouses. In fact, gains in business construction are more than offsetting the losses in homebuilding. Over the past three quarters, inflation-adjusted outlays for housing construction have fallen by nearly \$1 billion, the largest three-quarter drop in 5½ years. But business construction has soared \$20 billion, the biggest advance in 5½ years.

Strength in business structures and equipment output implies no big letup in capital spending, especially since spending plans remain strongly supported by surging profits, continued growth in consumer and foreign demand, and rising rates of capacity utilization.

Clearly, housing is exerting a drag on overall growth. But if the slowdown scenario envisioned by investors is going to play out as expected, there will need to be a lot more signs of softness outside of housing. So far, those signs are far from convincing. ■

## A FIRM FOUNDATION UNDER RETAIL SALES



## BUDGET DEFICIT

# Less Red Ink for Foreigners to Mop Up

**FOREIGNERS CONTINUE** to offer the U.S. plenty of help in financing its twin deficits in both the trade balance and the federal budget. And in the coming year, the financing burden for the budget deficit, at least, will be a lot smaller than expected, putting less pressure on foreigners to fill the gap.

According to the latest update of its budget projections, the nonpartisan Congressional Budget Office has sharply lowered its forecast for the fiscal year 2006 deficit to \$260 billion, down from the \$371 billion prediction in March. The 2006 gap is now expected to be only 2% of gross domestic product and to hold at 2.1% in 2007. That level is close to the long-term average and the lowest in four

years. The improvement from 3.5% of GDP in 2003 is especially impressive, given the government's massive outlays for the war in Iraq, combating terrorism, and hurricane relief efforts.

The shrinkage is coming from a surge in revenues. So far this fiscal year, which began last October, receipts are up 12.8% from the same period the year before, with outlays up 7.8%. Government coffers are

benefiting from the continuing strength in corporate profits through the second quarter as well as the acceleration in household income growth.

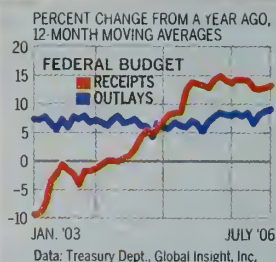
But according to economists at Barclays Capital, revenue sources are shifting. The growth of receipts from

profits has slowed this year, while revenues coming from households have picked up. The analysts say the trends suggest labor markets are tightening to the extent that households are starting to extract a bit larger piece of the income pie.

All this is not to deny the government's critical long-run problem in financing the retirement and health-care obligations of baby boomers. But for now, recent Treasury Dept. data show that foreigners boosted their purchases of U.S. securities for the second month in a row in June led by a surge in net purchases of Treasury bonds and notes. In June alone foreigners increased their buy of long-term Treasuries by some \$27 billion. Over the past year, foreigners have ponied up \$242 billion for Treasury bonds and notes, enough to finance 88% of Washington's smaller-than-expected pool of red ink. ■

—With James Mehring in New York

## SURGING REVENUES CUT THE DEFICIT



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# The Business Week

## News you need to know

EDITED BY HARRY MAURER



**Trying to Fix Ford** With low-mileage pickups and SUVs sitting forlornly in dealers' lots, Ford announced on Aug. 18 that it would slash fourth-quarter output by 20%—and it seems **Chairman and CEO William Ford Jr.** is weighing even more radical options. *The Wall Street Journal* says he has contacted **Renault-Nissan CEO Carlos Ghosn** about a possible tieup should his ongoing chat with **General Motors** yield no results. Ford already hired an investment banker to look at selling off assets such as **Jaguar** and **Land Rover**.

Ford also aims to ratchet up its restructuring. It will reveal plans in late September that will likely add to the 30,000 job cuts it announced in January. It could also add to the list of 14 plants set for closure (a Ford line, above) and may offer all its employees a buyout. Those moves, plus the production cuts, will make for some heavy losses.

See "Fixing Ford is now Job One," page 30, and **ONLINE** "Ford: Deeper cuts and diesel trucks," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**More Trouble at Dell** The world's biggest computer maker said on Aug. 17 that second-quarter profits sagged 51% and that the SEC was asking accounting questions—the latest signs of Dell having severe technical difficulties.

See "Dark days at Dell," page 26

**All Smoke, No Fire** In an Aug. 17 ruling, a federal judge slammed cigarette makers for causing a "staggering number of deaths" and ordered a halt to the use of the terms "light" and "low tar." Big loss for Big Tobacco? Nope, said

most observers, since the judge ruled she had no authority to order financial remedies. When the **Justice Dept.** filed racketeering case in 1999, it had sought up to \$280 billion. The defendants, including **Philip Morris** parent **Altria** and **Reynolds American**, will likely appeal the marketing curbs. Since this was the last major lawsuit the industry faced, Altria may soon see its way clear to split into three companies.

**Housing Gets Hammered** More signs of a housing smackdown: On Aug. 15, **Home Depot** reported a sluggish 5.3% profit hike. Home improvement rival **Lowe's** on Aug. 21 said profits rose 11% but lowered its sales and earnings outlook for the year. On Aug. 22 builder **Toll Brothers** reported a 19% drop in fiscal third-quarter profits as fewer buyers seemed ready to cough up \$600,000-plus for its fabled pads. The drumbeat continued on Aug. 23: The National Association of Realtors noted tumbling sales and fast-moving inventory of previously owned homes in July.

See "Dear Ben, feel our pain," page 11; "Housing: The roof won't collapse on the economy," page 12.

**ONLINE** and "Big box battle: Home Depot vs. Lowe's" [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

"Where the housing boom lives" [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Microsoft Enlarges the Pot** Shareholders may not be happy about Microsoft stock, but they aren't ready to bail out yet either. On Aug. 18 the software colossus revamped plans to buy back shares, slumbersome for much of the last four years, after investors tendered far fewer than anticipated. In July, Microsoft announced plans to buy \$20 billion in stock in a special offer, but investors tendered only \$3.8 billion worth in the price range offered. Now the company will add \$16.2 billion to its long-term buyback program, bringing the total to \$36.2 billion to be spent over five years.

See "Sign of an apocalypse in private equity?," page 12.

**Young's Bloop** Back in March, **Andrew Young**, onetime right-hand man of **Martin Luther King Jr.**, accepted a job as chairman of advocacy group **Working Families for Wal-Mart**. His prickly task: praising Wal-Mart's beneficence to low-income Americans via low prices and plentiful jobs. But after he was quoted by the *Los Angeles Sentinel* on Aug. 15 saying that Jewish, Korean, and Arab store owners were "ripped off" poor black communities for many years, even Wal-Mart turned its back on him. The company said it was "appalled" by the remarks. Young, a former mayor of Atlanta, quickly resigned and apologized.

**Vioxx Watch** Just when **Merck** thought it might be coming out of the legal intensive-care unit, having recently won two favorable results in lawsuits involving painkiller Vioxx, it suffered twin setbacks on Aug. 17. A federal jury in New Orleans ordered that the pharmaceutical pay \$51 million to a man who had a heart attack while taking the drug. And a New Jersey judge overturned an earlier pro-Merck verdict. The tally in Vioxx cases tried so far: Four for Merck, four against. Only about 14,000 to go.



**You've Got Grief** That's what they're saying around lunch-drunk **America Online**, which fired two employees and accepted its chief technology officer's resignation after the online service's release of Web search records of 8,000 subscribers. **CEO Jonathan Miller**, telling employees an e-mail that the **Time Warner** unit was taking steps "to help ensure this type of incident never happens again," set a panel to fortify its privacy policy. Now, about those 1 million folks who drop the service every quarter...

**Quattrone Walks** Former stratosphere-dwelling investment banker **Frank Quattrone** may be ready to soar again. After two trials on charges growing out of IPO allocation practices—one ending in a mistrial, the other in a conviction overturned on appeal—federal prosecutors threw in the towel. On Aug. 22 they inked a deal with Quattrone that allows him to avoid a third trial and resume his career. A Silicon Valley player in the 1990s, Quattrone earned as much as \$120 million a year while at **Credit Suisse First Boston**. Under the current accord, all charges will be dropped in 12 months if he keeps his nose clean.

**ONLINE** See "Quattrone's questionable comeback," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

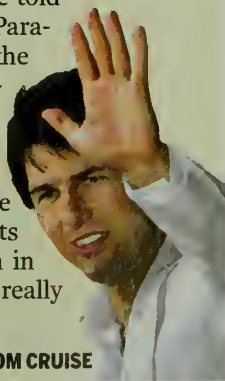
**Calhoun's Progress** He was named as a contender to run **Boeing** but instead will be top gun at the company that runs **Billboard** magazine. **David Calhoun**, 49, left **GE's** \$47 billion infrastructure unit on Aug. 23 to become CEO of **U Group**, a private Dutch media company that owns such properties as **Nielsen Media Research** and **The Hollywood Reporter**. So what does a man steeped in power turbines bring to the world of media? Strategic prowess, people skills, and, of course, cost-cutting chops.

## Divorce of the Week

Hey, Tom, sit down! No doubt that's what **Viacom Chairman Sumner Redstone** was thinking as he watched TV clips of his *Mission: Impossible III* star **Tom Cruise** jumping on **Oprah Winfrey's** couch while professing his love for **Katie Holmes**. Cruise's antics—he pushed his Scientology beliefs in a tense *Today Show* interview instead of promoting the flick—led Viacom's **Paramount Pictures** to dump him and the up to \$10 million annually it pays his production company. "His recent conduct has not been acceptable to Paramount," Redstone told *The Wall Street Journal*. In fact, Paramount had been haggling to trim the price of Cruise's 14-year-old "overhead deal," and the star was seeking funds from private-equity investors. So was Redstone negotiating in the press or just reading the tea leaves? *M:I III* earned more for its star than it did for the studio. Even in Hollywood, that kind of conduct really isn't acceptable.

See "Duds in the water," page 34

**TOM CRUISE**



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# DARK DAYS AT





# The tech industry's lean, mean direct sales machine is on the fritz, and there don't seem to be any easy fixes. What gives?

**BY NANETTE BYRNES, PETER BURROWS,  
AND LOUISE LEE**

**T**HESE ARE THE DOG days of Texas summer, with grass bleached yellow and the mercury hitting 100 by noon. But nowhere is the heat being felt like it is inside Dell Inc.'s no-frills compound outside Austin. For company founder and Chairman Michael S. Dell and CEO Kevin B. Rollins, this summer has been one mishap after another: a massive recall of potentially self-igniting laptop batteries, a dismal earnings report, and an announcement that the computer maker is under SEC scrutiny for the way it counts revenues. By mid-August, Rollins was being asked on CNBC about how long he would occupy the tandem corner office he shares with Michael Dell.

## **"THEY'RE A ONE-TRICK PONY"**

ROLLINS LOOKED TO BE the picture of calm in the face of the rebuke. But make no mistake, this is a pivotal moment for a tech icon. Dell may not have hit a wall in quite as dramatic a fashion as did Eastman Kodak or IBM. For all its problems, it is still expected to make nearly \$3 billion this year. Yet its predicament may be intractable. Dell remained slavishly loyal to its core idea of ultra-efficient supply-chain management and direct sales to consumers, even as rivals have stepped up their game and markets have shifted to take away some of Dell's key advantages. Instead of adapting, critics say, Dell cut costs in ways that compromised customer service and, possibly, product quality.

Says one top tech executive in reference to Dell's lean, mean direct-sales machine: "They're a one-trick pony. It was a great trick for over 10 years, but the rest of us have figured it out and Dell hasn't plowed any of its profits into creating a new trick."

The same operational focus that made Dell and Rollins so formidable when they were on top may get in the

way of finding another big idea. "Dell's culture is not inspirational or aspirational," says Geoffrey A. Moore, a tech consultant and author of *Dealing with Darwin: How Great Companies Innovate at Every Phase of Their Evolution*. "This is when they need to be imaginative, but [Dell's] culture only wants to talk about execution."

And Dell's execution isn't what it used to be. The company will make about \$900 million less in net income this year than it did in 2005, analysts estimate. It has slashed prices to maintain PC market share (19.2% in the second quarter) at the expense of operating margins, which slid to just 4.3% in the quarter ended Aug. 4 from 8.7% the year before. With the stock trading around 22, off its 2000 high of 58, blue-chip investment houses have fled. Fidelity Investments and Goldman Sachs are among those that have cut their Dell holdings by a third or more since Jan. 1 (table).

Dell is spending \$115 million to improve service, and its scores have improved recently. Still, some buyers have jumped ship. Peter Shoesmith, the network operations manager at 74-attorney firm Cummings & Lockwood in Stamford, Conn., once spent \$300,000 a year on Dell PCs and servers. Today, he uses Hewlett-Packard almost exclusively. For Shoesmith, Dell's products proved too hard to maintain and operate. "They grew too fast and tried to produce too many products at the same time," says Shoesmith. He would consider using Dell again but says "it'll take a lot for us to jump back."

At Dell's suburban Round Rock (Tex.) headquarters, many employees who once used Excel spreadsheets to track the rising value of their stock option grants now find Dell's hard-driving culture too much of a grind. Richard Snyder, an alum of Dell and HP and now CEO of Austin-based Forgent Networks Inc., gets a

WILLIAM DUKE



stream of disaffected workers applying for jobs. "They don't feel they're part of something at Dell, and they generally leave because they feel frustrated," says Snyder. "Dell is not a fun place to work, and it's less fun now than it used to be."

These various defections have the technorati buzzing about whether Rollins will be next to go. Dell turned down *BusinessWeek's* requests to interview Rollins and Michael Dell, and it wouldn't respond to specific questions about the business. But many who are close to the company doubt that Rollins will walk the plank anytime soon, if only because the two executives have been in lock-step since Rollins came from consultancy Bain & Co. in 1996. Michael Dell shows no signs of backing off: He has spent \$70 million to buy 2.9 million shares on the open market since Jan. 1 and holds 10% of the company. In a conference call with analysts on Aug. 17, Dell said his execs "are confident we're making the right long-term decisions for our customers and shareholders."

While Dell's problems may seem to have sprung up only recently, Rollins may have revealed the limits of its model in an interview with *BusinessWeek* back in 2003. "There are some organizations where people think they're a hero if they invent a new thing," he said. "Being a hero at Dell means saving money."

But it was clear some time ago that Dell's model was not keeping pace and was not going to be such a big advantage in the future. It's becoming harder for Dell to run one of its most profitable plays: luring customers to its Web site with cheapo models and then getting them to buy a \$2,500 box with all the bells and whistles. Now, PCs are so powerful that most consumers are fine with preconfigured models in stores. Some of Dell's other operational advantages are

## Down on Dell

Some big institutional investors have sold Dell shares this year

|                                | NO. OF SHARES SOLD SINCE JAN. 1 (Millions) * | PERCENT CHANGE |
|--------------------------------|----------------------------------------------|----------------|
| Fidelity Investments           | 29.7                                         | 32             |
| Sands Capital Management       | 23.5                                         | 100            |
| Wellington Management          | 20.3                                         | 56             |
| T. Rowe Price Associates       | 12.5                                         | 31             |
| Goldman Sachs Asset Management | 11.2                                         | 36             |
| AllianceBernstein              | 9.8                                          | 65             |
| Grantham, Mayo, Van Otterloo   | 9.5                                          | 49             |
| Columbia Management Advisors   | 9.3                                          | 77             |

\* As of most recent quarterly filing with Securities & Exchange Commission  
Data: Thomson Financial via Capital IQ and company filings

fading, too. Notebook PCs are becoming a far larger percentage of the market, but the Asian contract factories that make them for Dell also make them for other companies, eroding Dell's build-to-order advantage. And while experts believe Dell got the best prices on components when it was outgrowing all of its rivals, these days newly ascendant HP and Asian rivals Lenovo Group and Acer are offering plenty of growth themselves.

Even Dell's decision in May to end its exclusive deal with Intel Corp. by using chips from Advanced Micro Devices Inc. could cause short-term pain. The move was cheered by investors, but it comes just as Intel is introducing chips that close AMD's technology lead. "This may not be such a bad thing [for Intel]," says one Intel insider. "Exclusivity was great when Dell was growing faster than the rest of the world. But being tied to the hip to a company that is struggling isn't necessarily a good thing." This source thinks Intel may now tighten its links to Apple Computer Inc. and HP.

So why hasn't Michael Dell—clearly a brilliant guy—change tactics? For starters, say rivals and Dell alums, shifting gears would upset investors who expect hype profitability from Dell's hyper-efficiency. And having stuck to his gun in the past, he can't risk letting customers think that "Direct from Dell" is no longer the cheapest smartest way to go. That message isn't just a slogan, either: Inside Dell, ideas that break from the model are discouraged, say former Dell managers. Notes one: "You have to be very confident and thick-skinned to stay on an issue that wasn't popular. A lot of red flags got waved—but only once."

Now the cost focus may be making it harder to bring in fresh blood.

Three respected headhunters contacted by *BusinessWeek* said they would rather recruit from Dell than for it because working with the company is difficult and unprofitable. About two years ago, says one, Dell began an online bidding process for determining which firms would get its recruitment work. "They're trying to extend the process they use for buying memory chips and LCD screens to professional services," says the headhunter.

Dell insiders point to one small example of the pressure to maintain performance. In its efforts to diversify, Dell jumped into televisions back in 2001. TVs, like all electronic products, have met regulatory standards limiting how much electromagnetic interference (EMI) they produce. Dell, wanting to do better than meet the government standard, set an EMI level well below the legal limit, say two former Dell employees. The first models made a splash, and management wanted to keep momentum for a fall 2004 launch of LCD and plasma models. But in testing they didn't meet the higher goals, according to internal memos, copies of which were obtained by *BusinessWeek*.



## Dell: An Icon's Two-Year Slide

### JULY 2004

Kevin Rollins is promoted to CEO; founder Michael Dell remains chairman.

### FEBRUARY 2005

Rollins sets a goal of \$80 billion annual revenues in three to four years, from \$49 billion.

MICHAEL DELL AND KEVIN



OVER THERE

# Dell and Deutschland: Perfect Together

**H**ow's this for counterintuitive: Dell Inc. is struggling from Baltimore to Beijing but thriving in...Germany? That's right. In a country where 2% economic growth is grounds for euphoria and the PC market has shrunk 3.5% in the past 12 months, the troubled computer maker is doing better than ever.

Although it took years to get the formula right—Dell has been selling computers in Germany since 1988—the company grew faster there than any of its major rivals did in the past 12 months. Unit sales were up 13.6% in the second quarter vs. a year earlier, according to market watcher IDC. From fifth place last year, Dell has moved to third, with 12.6% of the market, behind Hewlett-Packard Co. and No. 1 Fujitsu Siemens Computers. Of Germany's top 10 computer suppliers, only Dell and HP managed to boost sales. Alain J. Bandle, an understated Swiss who runs Dell's German operations, won't disclose profits but says the company is making good money on his turf. "The mantra of Dell is: We want to grow profitably," he says.

Funny thing, though: In Germany, Dell closely follows the direct-sales model that



**SCORING POINTS** Dell uses native speakers to sell

seems to have lost its edge in the U.S. But Dell is giving its German team room to adjust the basic formula to appeal to local sensibilities. Bandle and his team "have been given a bit more leeway, which can only work in their favor," says Gartner Dataquest analyst Meike Escherich. For instance, personal contact still counts for a lot in Germany, so over the past year Bandle persuaded headquarters to let him nearly double the workforce, to 1,000. Most of the new hires are salespeople serving business customers, who account for 90% of Dell's German revenue. That also helps boost Internet sales, since companies typically buy their first Dell machine from a salesperson but make subsequent purchases online.

Bandle also realized that Germans prefer to buy from native speakers, even though they don't mind dealing with a foreigner on technical issues. So for a new center focusing on sales to small-business and government customers, Dell chose the eastern German city of Halle over an existing facility in the Slovak capital, Bratislava, racking up PR points in the process. Dell says the center could grow to 1,500 workers by the end of the decade, a sign that it expects its German success to continue.

Consumers account for only 10% of Dell sales in Germany, but even there the company has held its own. After discovering that Germany's tech-savvy gamers love Dell's \$1,800 XPS models, Bandle stepped up promotion of the machines, which soon became best sellers. And in a nation of engineers, Dell's build-to-order system has been a hit, especially compared with the typical sales channel for PCs, discount chains that buy thousands of identical computers and sell them on the cheap. That leads many observers to predict Dell's German growth story is far from finished. Says IDC analyst Elsa Opitz: "Dell offers good specs at a very competitive price."

—By Jack Ewing

redesigning the TVs to lower emissions would have taken weeks or months, forced Dell to miss the launch dates. After ordering suppliers to work around the clock and hiring contract engineers to try to fix the problem, Dell lowered its standards, according to the former employees. The memos indicate that some would ship without meeting the company's EMI goal, though they still would meet legal standards.

Other attempts to expand beyond PCs have come up dry. Dell dropped its DJ music player in January after tepid sales. Its stolid brand image doesn't help it in fast-growing consumer markets, and a tightfisted approach to R&D stunts new-product innovation. While Dell sells straight-up TVs, for example, HP just introduced a big-screen TV that can wirelessly grab whatever music, movies, and photos you have on your PC in the den.

As hard as things look, Dell is nowhere near as bad off as it was in 2001, when the tech bubble burst and companies stopped buying. Today, Dell is still adding new employees. Maybe they'll bring some bright ideas with them. ■

—With Gregory Hafkin in New York

**BusinessWeek** online

For a table that lists stock transactions by Dell executives, go to [www.businessweek.com/extras](http://www.businessweek.com/extras).

## DECEMBER '05

Stocks to \$80 billion now won't say I reach it.

## JANUARY 2006

Dell discontinues its DJ music player due to slow sales.

## JUNE '06

Web pictures show a Dell laptop burning in Japan.

## DECEMBER '05

Top execs as Asia chief Bill takes the CEO post from Lenovo.

## MAY '06

Dell quits giving quarterly earnings guidance and says it will miss first-quarter goals.

## JULY '06

The stock hits a nearly five-year low of 19.91, down from 58 in 2000.



## AUGUST '06

Dell recalls 4.1 million notebook batteries at risk of overheating. Quarterly earnings fall by half, to \$502 million.

**SUDDEN FLAMES: A LAPTOP CATCHES FIRE**

(BOTTOM L TO R) DARREN CARROLL FOR USA TODAY; WWW.THEINQUIRER.NET; (TOP) JENS SCHUETER/DDP



## Q&A

# FIXING FORD IS NOW JOB ONE

Bill Ford on doing “whatever it takes,” ditching brands, and family control

**SINCE FORD MOTOR CO.** Chairman and CEO William Clay “Bill” Ford Jr. assumed his post nearly five years ago, the company has racked up \$9 billion in losses and restructuring charges, cut 73,000 American jobs, and lost \$18 billion in stock market value. It’s no wonder that questions about his future role at the company—and even his family’s—have grown more persistent. Facing such a hostile climate, Bill Ford for the first time,

in an exclusive interview with *BusinessWeek*’s David Kiley, acknowledged that the company is willing to cut some of its brands and is looking for strategic alliances with other carmakers, possibly Renault-Nissan. He also insisted that his family is not contemplating ceding control of the company any time soon.

**Are you considering selling off or folding perennially problematic brands like Lincoln and Jaguar?**

We haven’t concluded what we are going to do yet... but [our turnaround strategy] certainly doesn’t preclude that.

**Outsiders are suggesting that maybe Ford should be a three-brand company, perhaps pared to just Ford, Volvo, and Land Rover. What do you think?**

Business as usual is not the model for us to have going. I’m not ready to get into the specifics yet, but yes, we are looking at radical changes.

**Do you and your family have emotional prejudices about these brands?**

No. The only prejudice is to fix Ford Motor Co. Whatever it takes to do that is what we will do.

**Does the sense of urgency mean your family is considering reducing its control of 40% of the voting shares of Ford?**

I don’t know why we would do that. That’s never been brought up. We have been part

of this company for 100 years. We’ve been there in good times and bad times.

**Some industry experts and analysts assert that family control makes it harder to attract top executive talent and potential alliance partners.**

We have alliances with [Peugeot] and with GM. We have a big alliance with Mazda. In no case was the family an impediment. In some cases, I think [partners] look at it as an advantage. They see it as stability. I have brought in a lot of talent over the years, so I don’t see [family control] as a stumbling block to hiring the best people.

**Have the nonfamily board members suggested to you that diminishing family control is something to consider?**

No. Look, whatever is required for the recovery, the family will not stand in the way. All our net worths are tied up in this. The family will not be a limiting factor to any plan that moves us forward.

“Business as usual is not the model for us... we are looking at radical changes”

—Bill Ford

**Are you, like GM, also interested in Renault-Nissan?**

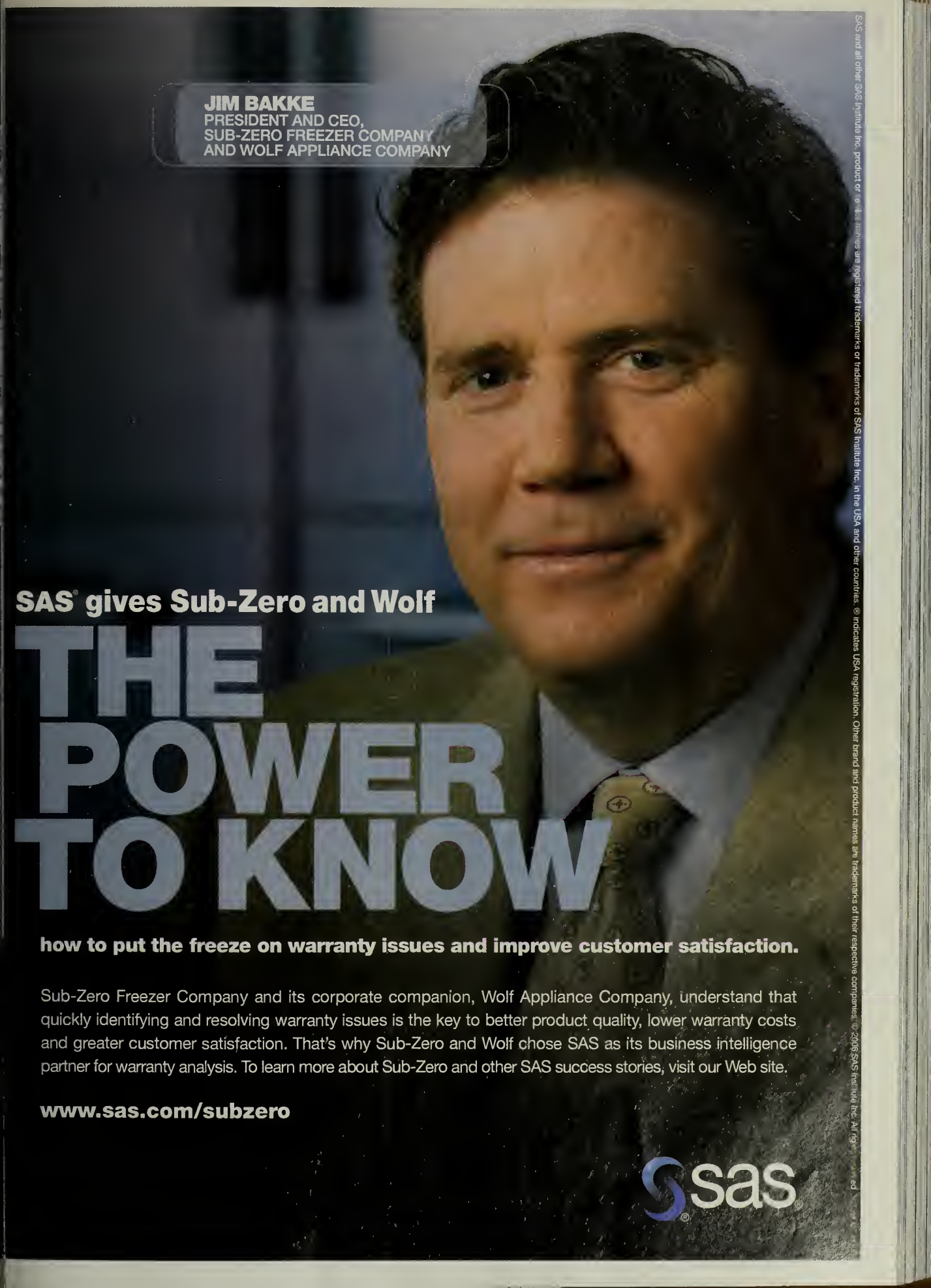
We are no stranger to alliances, but we wouldn’t want to comment on anything in the future. Naturally, when you look at the possible collaborations in our industry that are being talked about, we look at how those alliances might affect us. Let me assure you we’re not sitting on the sidelines waiting for things to happen. There are a lot of players out there gaming these things out, and we are, too. If we find someone with common interests, and it’s good for all of us, we’d like to do that.

**Are you the right one to fix Ford?**

One thing I have always said is that I’m not hung up on my own title. I’ll always look at talent that can help us move forward. We need somebody, and I think that somebody for right now, who knows how to get our manufacturing footprint right, our employee cost right, the product development right. [also] have a big labor contract up for renewal. Those are the areas I’m focused on. ■

**BusinessWeek online** For an extended interview with Bill Ford, go to [www.businessweek.com/extras](http://www.businessweek.com/extras)



A close-up portrait of Jim Bakke, a man with dark, wavy hair, wearing a suit and tie. He is looking slightly off-camera with a neutral expression.

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COMMENTARY

BY ROBEN FARZAD

# Sign of an Apocalypse In Private Equity?

The notion of a Microsoft buyout may signal a market gone batty

**C**OULD MICROSOFT BE BOUGHT OUT? That's precisely what the *Financial Times of London* recently called for. A consortium of private equity firms, the *FT* wrote, could cobble together the \$288 billion needed—nearly nine times more than the largest deal ever made. Why dare? “In truth,” wrote the *FT*, “Microsoft would be worth more off the [public] market than on it.” The fact that anyone is talking seriously about such a colossal deal might in itself signify the high-water mark of the private-equity boom. To consider Microsoft buyout bait is to believe that no target is too big. After all, money was no object when Bain Capital, Kohlberg Kravis Roberts, and Merrill Lynch Global Private Equity, among others, recently pulled off a \$33 billion deal for hospital operator HCA, eclipsing the size of the 1989 RJR Nabisco Holdings buyout. What's another quarter-trillion bucks among friends?

The idea of privatization is rooted in valid frustrations. A maturing Microsoft has been a lazy steward of its capital structure, which, with at least \$34 billion in cash and not a dime of debt, is lopsided and has been for years. That was fine when the stock was soaring. But Microsoft shares have round-tripped back to the price at which they traded this time eight years ago, despite the company tripling earnings per share and, since 2004, paying dividends in excess of \$39 billion. Management also failed to capitalize on an incredibly cheap debt market to bolster shareholder returns.

The go-private camp makes a fair point when it argues that buyout firms could probably trim enough fat from Mister Softie to make their enormous investment profitable. “In theory, someone could ‘cash-cow’ it and cut expenses to make it work,” agrees L. Alan Davis, an analyst with Lake Oswego (Ore.) investment bank D.A. Davidson & Co.

But practically speaking, it's not going to happen. “*Snake a Plane* will win a best picture Oscar before Microsoft gets acquired by LBO firms,” sniffed Daniel Primack, editor of *PE Wire*, a daily private-equity e-mail newsletter.

For starters, the *FT* plan assumes Microsoft management ready to raise the white flag, when in fact it's still keen to invite billions more to take on rivals like Google Inc. Going private would mean gutting billions from research and development and paring thousands of employees just to service the new deal, starving the pipeline of new products (and by extension, squeezing future profits).

The equity portion of a Microsoft megabuyout would have to be at least \$30 billion and more like \$50 billion or \$80 billion would be a stretch for 15 shops even to come up with, \$4 billion apiece (a prohibitively large chunk of even the lead buyout funds), much less join together in harmony. And even

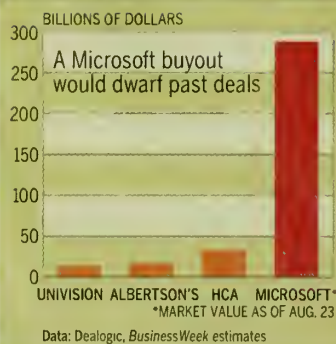
they somehow scared up \$80 billion, \$200 billion so in debt would still have to be financed on daredevil terms. “In software,” says A.G. Edwards & Sons Inc. analyst Yun Kim, “it's kind of leverage just is done.”

There is, of course, another way—one that has the benefit of being rooted in reality: privatization lite. Microsoft could devote much more of its free cash to share buybacks and fatter dividends (which the LBO group

would surely pay themselves anyway). Investors seem to like that notion. Most refused to cash in their shares at the high end of Microsoft's recent tender offer, holding out for a higher price. The stock has gained 20% since June. Microsoft upped the ante by jacking up its buyback plan by more than \$16 billion, to \$36.2 billion.

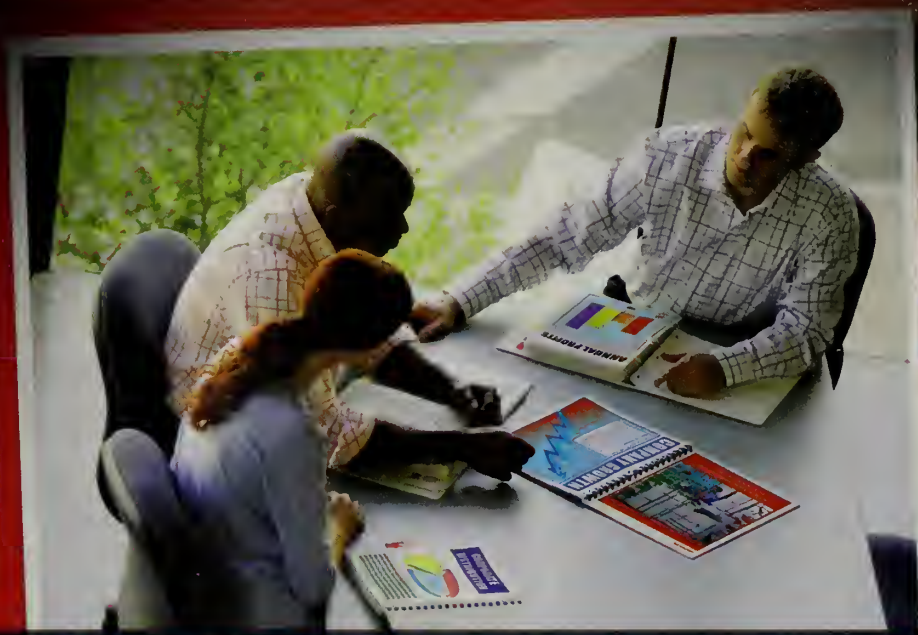
Not enough juice? Then it could take out a slug of debt to absorb even more of its shares outstanding. It's conceivable that Microsoft could safely reabsorb a quarter of its share count, all to Reclaim those stock certificates, and each remaining holder a fatter claim on earnings that stand to pick up over time. While that solution might not be a \$288 billion LBO-zilla, it's the kind of results-oriented deal that the Brits might hoist a pint to.

## BIGGEST BUYOUTS OF 2006

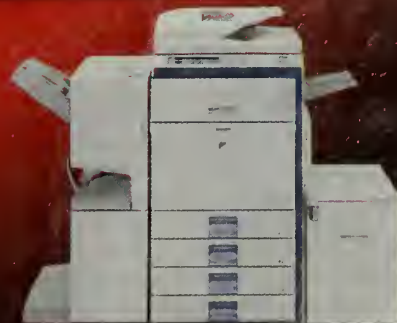


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## HOLLYWOOD

# DUDS IN THE WATER

The "smart money" sees slim returns from films

BY RONALD GROVER

**A**S RISKY MOVIES GO, few were more fraught this summer season than the disaster remake *Poseidon*. It featured no big stars, cost an estimated \$160 million to produce, and had to battle the public's nostalgia for the cheesy but successful original. Few industry watchers were particularly surprised when the movie sank like, yes, an overloaded cruise ship.

Good thing *Poseidon*'s maker, Warner Bros. Inc. got someone else to pay half the up-front costs—and absorb half the potential losses. An equity fund created by Stark Investments, a \$7.5 billion hedge fund based in Milwaukee, has invested about half a billion dollars in six Warner films, including *Poseidon* and *V for Vendetta*, another dud. Based on a *Busi-*

*nessWeek* analysis, Stark has so far lost \$25 million on its *Poseidon* misadventure, and a little less on *V*. There is already blood in the water: The hedge, which declined to comment for this story, has parted ways with the former investment banker who was advising it.

The studios have been using other people's money forever, often from wannabe tycoons with only a tentative grasp of Hollywood's creative dealmaking. But recently the so-called smart money has been flooding into Tinseltown. Over the past two years, private-equity firms have ponied up nearly \$5 billion, with everyone from Merrill Lynch & Co. to Credit Suisse First Boston joining the stampede.

The finance pros figured they had moviemaking all figured out. But several megaflops have some Hollywood insiders wondering if the private-equity guys are in way over their heads. "It's tough to be an investor when the studio gets to pick the films and you stand behind them in line to get paid," says leading Hollywood banker John W. Miller of JPMorgan Securities. "It's hard to see how you can get more than single-digit returns—if you're lucky."

The Wall Streeters arrived in Hollywood armed with sophisticated models that they say will protect them from losses. Essentially they project film profits based on the records of directors, stars, genres, and even distribution dates. "You can never take the risk out of investing in a film," says Ryan Kavanaugh, head of Relativity Media, which has a pretty good record. It raised a \$600 million fund with Deutsche Bank to provide financing for Paramount Pictures and Universal Studios films. "But you can mitigate it by choosing those that meet rigorous criteria." And to minimize the downside of any one film that may bomb, private investors often put money into 20 or more flicks.

It's not exactly bullet-

proof. Ask Legendary Partners. A \$5 million fund set up by two Hollywood veterans and backed by ABRY Partners, AIG Direct Investments, and BancAmerica Capital Investors, Legendary plans to invest in 25 Warner films, backed *Lady in the Water*, the animated *Ant Bully*, and *Batman Begins*. While the fund spokeswoman says it's too early to judge its performance, the first two films were flops, so Legendary will be lucky to break even on them.

Making a hit movie doesn't guarantee a rich payday, either. *Superman Returns* falls into that category. Since its June release, the Warner film has grossed a very respectable \$337 million-plus worldwide. Yet according to an investment banker who crunched the numbers, *Superman* will earn a paltry \$25 million for Legendary, which teamed up with the Heywell International pension fund for the deal. That's barely a 7% return over years, or the time it will take for profits to roll in from the box-office take, DVD sales, and TV showings.

## BACK OF THE LINE

WHY IS IT SO HARD for outsiders to make money in Hollywood? Ballooning budgets and skyrocketing marketing costs don't help. But the studios game the system, too. They insist on distribution fees of 10% to 15% before sharing profits with investors. And backers often have to stand in line with stars and directors, who tend to want a piece of the action. Besides, studios make investors take the risk on movies while keeping likely hits for themselves. Credit Suisse First Boston invested \$505 million in Walt Disney Co. films, but the studio didn't let the firm in on two summer moneymakers, *Pirates of the Caribbean: Dead Man's Chest* and the animated smash *Cars*.

Maybe the private-equity guys should follow Merrill Lynch, which launched one of the first funds with Paramount, but since switched to financing film directors like Ivan Reitman, who got better terms. They could talk to Aron Malin. The former CEO of studio Artisan Entertainment Inc. now manages Qualia Capital, which focuses on media and entertainment investments. Malin has turned down several production deals. What's he investing in? Film libraries. With them, the risky part is over. ■

## THE STAT

**\$25**  
Million

Estimated loss to the private-equity firm Stark Investments on the movie *Poseidon*

Data: BusinessWeek

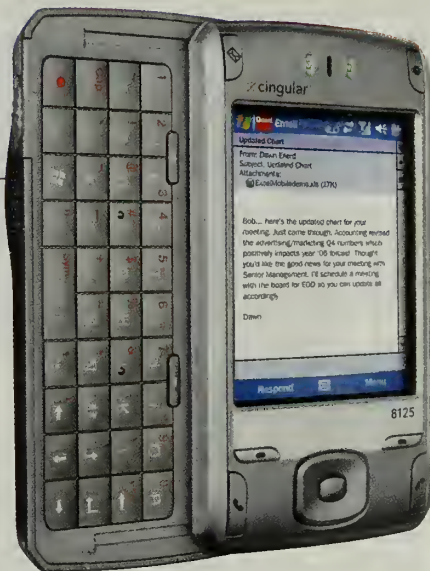


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## E-COMMERCE

# THE HOT TICKET ISN'T TICKETMASTER

The giant is taking aim at increasingly popular Web resellers

BY SARAH LACY

**Z**ACH NELSON, CEO OF software supplier Net-Suite Inc., doesn't have a lot of time for entertainment. But when he wants to see a concert, say Snoop Dogg in Las Vegas last year, he wants good seats. Nelson doesn't even try Ticketmaster. He logs right on to StubHub.com, an open marketplace where fans, amateur speculators, and ticket brokers unload tickets at whatever price they can get. Nelson picks his seats, happily pays up, and bam, he's set.

Millions of others are doing the same, which is why a \$2 billion online market for hard-to-find tickets has sprung up and is doubling in size each year. Most of the action is on eBay Inc. and StubHub, where anyone can list a ticket for any event, and anyone can buy them. Other fast-growing outfits such as RazorGator, TicketsNow, and TicketLiquidator cater more to ticket brokers.

Ticketmaster, the titan of traditional ticketing, is none too happy. And it's fight-

ing back hard. It has expanded its fledgling TicketExchange resale site to include concerts and other events, putting it in direct competition with eBay, StubHub, and the rest. In the spring, the unit of Barry Diller's InterActive Corp. launched a lobbying campaign in some states to get legislation making online ticket buying and selling for even \$1 over face value illegal unless the team or venue controls it and gets a cut of the proceeds. That would be an advantage for Ticketmaster, which already has many such deals and has struck exclusive agreements with some 44 pro teams to resell season seats on TicketExchange. Ticketmaster has gone so far as to "turn off" tickets that were resold on sites like eBay and StubHub by invalidating the bar code.

The war of words is just as nasty. On the TicketExchange home page is a link reading: "Been Scammed by a Scalper? Click here to tell us what happened; we

**MADONNA** Artists are losing out because of resellers, argues Ticketmaster

might be able help." It asks fans to detail their stories, and under "where did you buy?" offers options including eBay, StubHub, Craigslist, TicketsNow, RazorGator, and a generic "street corner scalper." There's a box to check if you're willing to talk to the press. David Loe, CEO of RazorGator, cries foul: "We sold 10% of last year's Super Bowl tickets and didn't have one fraudulent ticket."

## MARGINS, SHMARGINS

CUT THROUGH ALL the rhetoric, and this is really a dispute about whether a concert or game ticket is inherently different from other items people can buy and sell online. Ticketmaster President Sean Moriarty maintains that he is protecting the interests of his customers: the stadiums, concert halls, promoters, and teams that put substantial money at risk to stage an event and that essentially leave billions on the table when other people resell the best seats at high prices. Fans should be able to buy and sell tickets, Moriarty says, but with restrictions—similar to the rules that govern stock trading. "If a team or venue wants to put certain conditions on this retail product, they should have the right to do that," says Moriarty.

Resellers have no interest in protecting margins of teams and venues: Their customers are fans and speculators. In fact, while tickets frequently go for more than face value, they don't always. Resellers argue that by letting buyers see hundreds of tickets for an event on one screen, as opposed to dealing with a local broker or parking lot scalper, they force speculators to compete with one another.

In the eyes of the upstarts, Ticketmaster is just another entrenched industry trying to protect its turf. To StubHub founder and CEO Jeff Fluhr, who started the service in a dorm room at the Stanford University School of Business years ago, the outcome is inevitable.

Fluhr points out that Ticketmaster's efforts to craft legislation have so far come up short.

Meanwhile, StubHub has grown to be the largest ticket resale auction site on eBay. More than 1,000 fans bought tickets at Madonna's June 6 performance at New York's Madison Square Garden through their tickets through the site. Taunts Fluhr: "Bring it on, Ticketmaster." ■

**Ticketmaster has even "turned off" tickets sold by the upstarts**

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SPAIN

# FASHION CONQUISTADOR

Zara's quick turnover lures shoppers, but global expansion could be a strain

BY KERRY CAPELL

**I**T'S FAST, IT'S FASHIONABLE, and it's out to conquer the world from a remote corner of northwestern Spain. Inditex, parent of cheap-chic fashion chain Zara, has transformed itself into Europe's leading apparel retailer over the past five years, and is now aiming to rev up growth in Asia and the U.S. But as Chief Executive Pablo Isla maps out plans for global expansion, some are wondering whether Inditex is moving a little too fast for its own good.

Make no mistake: The company's track record is pretty impressive. Since 2000, Inditex tripled its sales and profits as it has doubled the number of stores of its eight brands. (Zara is the biggest, accounting for two-thirds of total revenues.) Now Isla, 42, expects to open more than one outlet each day in coming years, for a total of more than 4,000 by 2009, up from 2,800 today. Zara already has some 40 stores from Bangkok to Tokyo, while its first shop in Shanghai opened earlier this year. In the U.S., Zara plans to double its store count, to more than 50, by 2009, focusing largely on the coasts. Too fast? No way, says Isla. "We think we can

keep up the pace of expansion without endangering profits," he says.

Others aren't so sure. As Zara ventures deeper into far-flung territories, it risks losing its speed advantage. That's because Zara turns globalization on its head, distributing all of its merchandise, regardless of origin, from Spain. With more outlets in Asia and the U.S., replenishing stores twice a week—as Zara does now—will be increasingly complex and expensive. The strain is already starting to show. Costs are climbing and growth in same-store sales is slowing: At outlets open two years or more, revenues were up by 5% last year, compared with a 9% increase in 2004. "The further away from

Spain they move, the less competitive they will be," says Harvard Business School professor Pankaj Ghemawat. "As long as Zara has one production and distribution base, its model is somewhat limited."

So far, the company has managed to offset that problem by charging more for its goods as it gets farther from headquarters. For instance, Zara's prices in the U.S. are some 65% higher than in Spain, brokerage Lehman Brothers Inc. estimates.

**SHANGHAI STYLE**  
Models at Zara's Chinese flagship



With its breakneck expansion, Zara is a growing threat to rivals such as Gap and Sweden's H&M Hennes & Mauritz. A decade ago, Inditex was a middling retailer focused largely on Spain, with sales of \$1 billion and net income of \$100 million. Today, it boasts stores in 64 countries. Last year sales rose 21%, to \$8.5 billion, while profits jumped 26%, to \$1.1 billion. The Gap may have more stores and bigger revenues—\$16 billion last year—but Zara's 16.2% margins are much better than the Gap's 10.9%. Although H&M has slightly higher sales and profits and better margins (21.5%), it is in just 22 countries and can't match Zara in reacting to the latest trends. "One does speed like Zara," says Richard Clifton, London chairman for brand consultancy Interbrand.

## CULTIVATING EXCLUSIVITY

ZARA HAS SUCCEEDED by breaking every rule in retailing. For most clothing stores, running out of best-selling item is a disaster, but Zara encourages occasional shortages to give its products an air of exclusivity. "We don't want everyone wear the same thing," Isla says. With new merchandise arriving at stores twice a week, the company trains its customers to shop and shop often. "If you see something and don't buy it, you can forget about coming back for it because it will be gone," says Elisabeth Garcia Cueto, a 21-year-old student in Barcelona.





## While rivals outsource, Zara uses company-owned factories

we can react quickly.”

Zara’s nerve center is an 11,000-square-foot hall at its headquarters in Arteixo, a town of 25,000 in Galicia. That’s where hundreds of twentysomething designers, buyers, and production planners work in tightly synchronized teams. It is there that the company does all of its design and distribution and half of its

and forget about setting  
ids; Zara prefers to follow  
m. Its aim is to give cus-  
omers plenty of variety at a  
e they can afford. Zara  
de 20,000 different items last year,  
ut triple what the Gap did. Rifling  
ough the racks at Zara’s store on New  
k’s Fifth Avenue, Dana Catok, a 25-  
r-old administrative assistant, says:  
Gap, everything is the same.” It’s a  
timent echoed by Zara fans the world  
r. “You’ll never end up looking like  
eone else,” says Mariela Raimundez,  
4-year-old architect and a regular Zara  
pper in Madrid.

### LOCAL LABOR

From drawing board to shop floor in two weeks

and cost. So while rivals outsource to Asia, Zara makes its most fashionable items—half of all its merchandise—at a dozen company-owned factories in

Spain. Clothes with a longer shelf life, such as basic T-shirts, are outsourced to low-cost suppliers, mainly in Asia and Turkey.

The tight control makes Zara more fleet-footed than its competitors. While rivals push their suppliers to churn out goods in bulk, Zara intentionally leaves extra capacity in the system. That results in fewer fashion faux pas, which means Zara sells more at full price, and when it discounts, it doesn’t go as deep. The chain books 85% of the full ticket price for its merchandise, while the industry average is 60%. “We have greater flexibility,” says Isla. “We can commit to a low level of purchases at the beginning of each season, so that when new trends emerge

production. The concentrated activity enables it to move a dress, blouse, or coat from drawing board to shop floor in just two weeks—less than a quarter of the industry average.

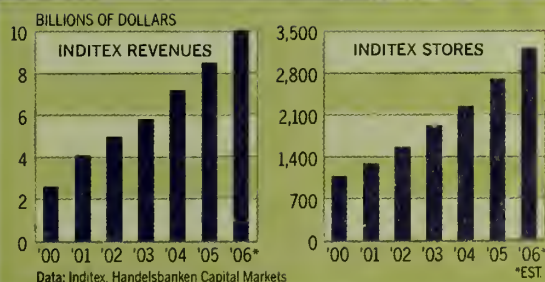
This summer, Zara managed to latch onto one of the season’s hottest trends in just four weeks. The process started when trend-spotters spread the word back to headquarters: White eyelet—cotton with tiny holes in it—was set to become white-hot. A quick telephone survey of Zara store managers confirmed that the fabric could be a winner, so in-house designers got down to work. They zapped patterns electronically to Zara’s factory across the street, and the fabric was cut. Local subcontractors stitched white-eyelet V-neck belted dresses—think Jackie Kennedy, circa 1960—and finished them in less than a week. The \$129 dresses were inspected, tagged, and transported through a tunnel under the street to a distribution center. From there, they were quickly dispatched to Zara stores from New York to Tokyo—where they were flying off the racks just two days later. ■

—With Marina Kamenev in London and Nichola Saminather in New York

### NEVER FAUX PAS

LABORATIONS with big-name designers and multimillion-dollar advertising campaigns? Zara eschews both. Instead, it uses its spacious, minimalist outlets—more Gucci than Target—and catwalk-inspired lighting to build its brand. “Our advertising is our stores,” says . “The money we save is put on top locations.” Zara is one of the world’s priciest retailers: Fifth Avenue, Tokyo’s Ginza, Rome’s Via Condotti, and the Champs-Élysées in Paris. Keeping those locations flush with an ever-changing supply of clothing means striking the right balance between flexibility

### FAST FASHION, FASTER GROWTH



**BusinessWeek** online For a slide show on Zara’s operations, please visit [www.businessweek.com/extras](http://www.businessweek.com/extras)



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In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision. It is not possible to determine whether these events are related directly to these medicines or to other factors. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

The most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less common are bluish or blurred vision, or being sensitive to light. These may occur for a brief time. Remember to protect yourself and your partner from sexually transmitted diseases.

*Please see our patient summary of information for VIAGRA (25 mg, 50 mg, 100 mg) tablets on the following page.*

VIAGRA is available on most Managed Care Plans.\* VIAGRA is one of several ED treatments that you and your doctor can consider.

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# VIAGRA®

(sildenafil citrate) tablets

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This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

## • What Is VIAGRA?

VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

## • How Sex Affects the Body

When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

## • How VIAGRA Works

VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

## • VIAGRA Is Not for Everyone

As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- Nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- Isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

## • What VIAGRA Does Not Do

- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV—the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

## • What To Tell Your Doctor Before You Begin VIAGRA

Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- Have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- Have ever had a stroke
- Have low or high blood pressure
- Have ever had severe vision loss
- Have a rare inherited eye disease called retinitis pigmentosa
- Have ever had any kidney problems
- Have ever had any liver problems
- Have ever had any blood problems, including sickle cell anemia or leukemia
- Are allergic to sildenafil or any of the other ingredients of VIAGRA tablets

- Have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- Have stomach ulcers or any types of bleeding problems
- Are taking any other medicines

## • VIAGRA and Other Medicines

Some medicines can change the way VIAGRA works. Tell your doctor about any medicines you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking medicines called alpha-blockers for the treatment of high blood pressure or prostate problems, your blood pressure could suddenly drop. You could get dizzy or faint.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

## • Finding the Right Dose for You

VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

Your doctor may prescribe a lower dose of VIAGRA in certain circumstances. For example:

- If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA.
- If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period.
- If you have prostate problems or high blood pressure for which you take medicines called alpha-blockers, your doctor may start you on a lower dose of VIAGRA.

## • How To Take VIAGRA

Take VIAGRA about 1 hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

## • Possible Side Effects

Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision in one or both eyes. It is not possible to determine whether these events are related directly to these medicines, to other factors such as high blood pressure or diabetes, or to a combination of these. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

## • Accidental Overdose

In case of accidental overdose, call your doctor right away.

## • Storing VIAGRA

Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

## • For More Information on VIAGRA

VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit [www.viagra.com](http://www.viagra.com), or call 1-888-4VIAGRA.

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# COMMENTARY

BRIAN BREMNER AND NANDINI LAKSHMAN

## India: Behind the Scare Over Pesticides in Pepsi and Coke

Are they being unfairly targeted because they're outsiders?

**F**EARLESS RESEARCHERS NAIL two big, bad American multinationals selling toxic soda to India's masses? Get Bollywood on the line! Unfortunately for Coca-Cola Co. and PepsiCo Inc., this scenario isn't a film pitch. An anti-corporate lynch mob has pursued the pair of soda makers since Aug. 9, when a New Delhi environmental group released data purporting to

show their soft drinks contain levels of pesticides that greatly exceed proposed Indian safety standards. In response, several Indian states banned sales of Coke and Pepsi.

If the companies have been negligent, of course, they deserve to be punished. But so far it appears that they have been singled out because they are foreign-owned. No Indian drink makers have been tested for similar violations, even though many people believe that pesticide levels are much higher in Indian-made milk and sweetened tea. And while pesticide

residues are present in virtually all groundwater in India, New Delhi has largely ignored the problem. "We are continuously challenged because of who we are," says Atul Singh, CEO of Coca-Cola India.

It's nothing personal, counters Sunita Narain, director of the Center for Science & Environment, the group that published the pesticide data. The CSE made the charges simply because the companies "violated safety standards in India."

Narain's protestations notwithstanding, it sure looks like India—where all those American software and back office jobs go—where they're "BangalORIZED"—is having its own xenophobic moment. Some members of the Hindu nationalist Bharatiya Janata Party have called for a nationwide ban on Pepsi and Coke. And BJP party activists have smashed bottles and staged mock funerals to express their outrage.

The whole affair is bad for India. Sure, the economy has been growing at 8%-plus over the last three years. But much of that

expansion has been fueled by the vibrant information technology and outsourcing sectors, which do little to help India's millions of unskilled workers. And while the \$5.5 billion India drew last year in overseas investment isn't bad, it pales beside China, which pulled in 10 times as much.

What India needs is more investment in manufacturing—even by makers of soda pop—if it hopes to improve the lot of its 350 million living in poverty. Together, Coke and Pepsi have invested nearly \$2 billion in India over the years. They employ about 12,500 people directly and support more than 200,000 indirectly given their huge purchases of India-made sugar, packaging material, and shipping services. Coke is even India's No. 1 consumer of mango pulp for one of its local soft drink offerings. If these two keep getting mauled, other potential investors just

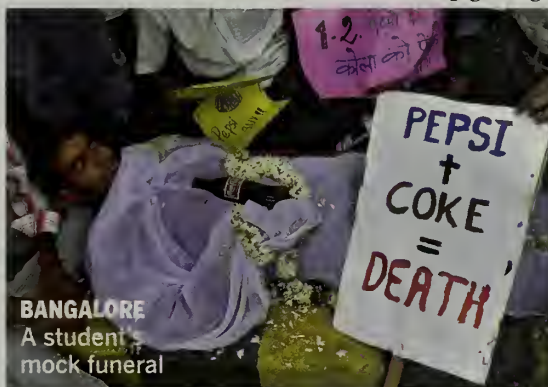
might reconsider their plans. "India's credibility may come into question," says S.K. Poddar, head of the Federation of Indian Chambers of Commerce & Industry.

Coke and Pepsi are doing what they can to cap the frenzy. They cite research from labs overseas certifying the safety of their products in India, and say that the data released by CSE are inconclusive. The companies may have a point. Even India's Health Minister, Anbumani Ramadoss, on Aug. 22 questioned the validity of the methods the environmentalists used to test the sodas.

It's also hard to square the outrage when New Delhi hasn't even formalized its own regulations. The levels that Coke and Pepsi are said to exceed—by 24 times—are still proposals that won't go into effect until early next year. And both companies have been strong supporters of new standards. "It's absolutely in our interest to have clear regulations that are scientifically

verifiable," says Mike White, chief executive of PepsiCo International. New Delhi would do better to get its own house in order and let Bollywood dream up tales of corporate villainy.

—With Diane Brady in New York



BANGALORE  
A student's  
mock funeral

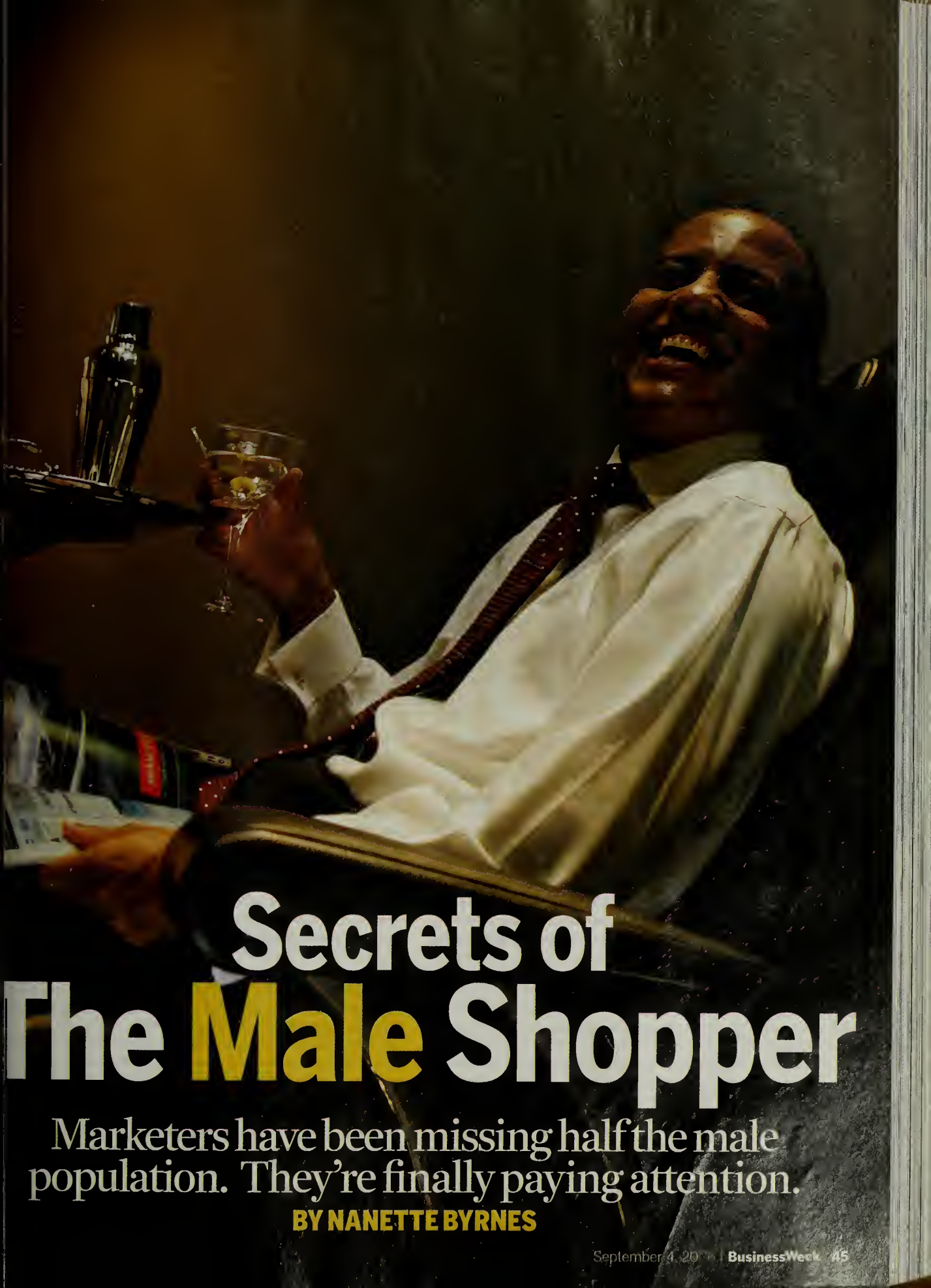
### Questions arise about the lab tests as politicians have a field day





PHOTOGRAPH BY KATHERINE LAMBERT;  
IMAGING BY RICHARD MICHEL/BW

**HOW SWEET IT IS**  
Greg Gary gets a  
pedicure at the  
Grooming Lounge in  
Washington



# Secrets of The **Male** Shopper

Marketers have been missing half the male population. They're finally paying attention.

**BY NANETTE BYRNES**



## A Handy Guide to the Male Shopper

**WARNING:** Guys may or may not recognize themselves among these archetypes. But a century after marketers drew a big bull's-eye on the female consumer, slicing up the male market is long overdue. Anything to get past the fixation on the metro and the retro.



### The Metrosexual

Despite widespread reports of his demise, this affluent urban sophisticate aged 20 to 50 absolutely shops on. To him, it's more than mere commerce. He's not just buying the things he needs, he imbues his consumerism with a deeper meaning, quality, and beauty. Think loafers as objets d'art. Thanks to him, marketing to men may never be the same. Nor will men's grooming. The likes of **P&G, Beiersdorf, and Polo Ralph Lauren** are doing good business with the metro.



### The Maturitee

This guy is more savvy, responsible, mature, and pragmatic than previous cohorts. Culture watchers attribute this to baby boomer parents who treated their kids as equals. He's a technology master, so he's adept at online research and often acts as a house shopping consultant. These guys never knew a time without the Web, and its interactivity has nurtured in them a radical view of brands. They own **Adidas, Sony, and Unilever** are especially skillful at playing along

**A** COUPLE OF YEARS AGO, YOU COULDN'T ESCAPE the metrosexual. He was everywhere, with his Paul Smith pinstripes, \$100 haircuts, and chemical tan. This character became so much a part of the zeitgeist that some regular guys began wondering if they were metrosexual. He seemed hip and urban. Women, it was said, loved him because he smelled good and knew gabardine from twill. And if a man wasn't a metrosexual, he risked being tagged as the metro's alter ego: the retrosexual, a guy's guy who wouldn't be caught dead wearing chartreuse.

In the Age of the Metrosexual, mission shopping (know what I want, know where to get it) was out. A visit to Barneys or Nordstrom became an indulgence in style. On cable, ratings soared as the Fab Five of *Queer Eye for the Straight Guy* repurposed the style-challenged as hip and urbane. Condé Nast Publications jumped in with *Cargo*, a shopping magazine (of all things) for men. From the image factories of Madison Avenue came a slew of ads aimed at the new, preening male shopper. And the folks in white lab coats got busy cooking up lotions and potions with names like Nivea for Men Revitalizing Eye Relief Q10.

Now Madison Ave has turned on the metrosexual. Why? Because he's half the man he was cracked up to be. Not only is this archetype too feminine for most men, he's also pretty rare—maybe one-fifth of the U.S. male population, according to a recent study by Leo Burnett Worldwide Inc. As for the retrosexual, star of the sophomoric beer ad, he's not that common either. Put all the metros and retros together, and they probably

add up to fewer than two in every five men, says Leo Burnett.

So who is the elusive man in the middle of the two extremes? Truth is, marketers are only beginning to understand the secret of the male shopper. It stands to reason that just as women broke down into subsectors, so do men. By targeting just the metro and the retro, Mad Ave has been ignoring half the male population. Largely forgotten are the millions of boomer dads, who shop a lot more than their fathers or grandfathers ever did. Also often overlooked is the army of men in their 20s and 30s who care about their appearance but still like to drink beer and watch sports. The male teen is another big shopper, a sophisticated consumer with the Web research skills to give him an outsize say in family purchases. We don't hear a lot about him, either. (Our guide to the forgotten guys and their metro and retro brethren is above.)

The challenge will be reaching these men and moving beyond the heavy focus on the extremes. "Men are portrayed in a lachrymose, foonish, sophomoric way or as sensitive, feminized men," says Erv Frederick, who heads the Miller Lite brand. "The bulk is somewhere in the middle, and those are men who haven't been spoken to." No lie. According to Leo Burnett, 79% of American men say they can barely recognize themselves in advertisements.

The creation of the metro was supposed to rectify that problem by speaking to a generation of men who have taken on more traditional female roles and, yes, buy a lot of things—diapers, skin creams, vacuum cleaners—that women have long shopped for. Consider the explosion in male grooming, where sales of men-only products surged 14% in 1995, according to NPD Group. And in recent years, the average growth in men's apparel sales





## The Modern Man

retro nor metro, he's  
ing in the middle. A  
icated consumer in his 20s and  
's a bigger shopper than his dad  
just as much a Seahawks fan.  
mfortable with women but  
find shopping with them much  
nk of it this way: Moisturizer and  
are perfectly ordinary to him; a  
re is a tougher call. **Philips**  
o used locker room humor to get  
dern man comfortable with its  
he-neck shaver, Bodygroom.



## The Dad

Is any species of guy more ignored?  
Once men get married and have a few  
kids, they drop off the radar screen.  
When they do appear at all, chances  
are it's as the goofy father looking for  
advice from his kid on how to be cool.  
Yet these men tend to be in their peak  
earning years. Plus, they are almost  
as likely to be found strolling down  
the diaper aisle as mom is. Smart  
companies such as **Dyson** and  
**Patek Philippe** are reaching out to  
these guys.



## The Retrosexual

If the metrosexual champions the  
female ethos with a "Go girl!" the  
retrosexual is screaming "Stop!"  
This traditionalist has lived through  
the same cultural turmoil and  
consumerism as the modern man and  
the metro, but rejects feminism and  
happily wallows in traditional male  
behavior. He is nostalgic for the way  
things were in the good old days, before  
the Fab Five and moisturizers for men.  
**Burger King** has this dude nailed. So  
does **P&G's Old Spice** brand.

held steady at nearly 5.5%, in some years even outpacing the  
with in sales of women's clothing.  
With the metro losing his mojo, marketers and researchers  
now scrambling to come up with a more nuanced view of  
male consumer. And a range of companies are going after  
n as never before. KB Home is building townhouses for sin-  
men. Adidas Group and Coca-Cola Co. are stepping up their  
orts to win over teen males. And Dyson, maker of the revolu-  
tionary British vacuum cleaner, is a hit with boomer dads.

## Shrinking Male Habitat

A BIG SWITCH. After all, men have been a marketing after-  
thought for more than a century. Starting in the late 1800s, when  
*Housekeeping* and *Cosmopolitan* began teaching genera-  
tions of women how to be Type A wives and mothers, brand  
managers painted a giant bull's-eye on the female consumer.  
They've taken relentless aim ever since. "He makes. She buys."  
It's the calculation that turned women into shoppers and men  
into providers," says James B. Twitchell, who teaches English and  
advertising at the University of Florida.  
And if it's confusing trying to sell stuff to men, that's partly be-  
cause many guys are confused, too. Society has changed a lot,  
flipping notions of gender identity. Not only have women as-  
signed themselves at work and at home since the 1960s, but bas-  
is of male bonding—the barbershop, golf club, U.S. Army—  
have largely become unisex, a shrinking of the male habitat that

Twitchell highlights in his book, *Where Men Hide*. Women are  
acting more like men. And men are acting more like women.

Of course, large swaths of maledom remain defiantly macho.  
But younger men—those in their 20s and 30s—grew up in a  
world where women held increasing sway. With nearly half of  
all U.S. marriages failing, many of these guys were raised by a  
single mom. Growing up under her roof, it's only natural that  
they would adopt more of her traits, interests, and habits than  
their predecessors. "Men under 35 shop more like their sisters  
than their fathers and grandfathers," says Wendy Liebmann,  
president of WSL Strategic Retail. "They shop the same kinds of  
places. They're not just in and out fast, but are people who like  
to browse, use shopping as a community experience."

That's why Madison Avenue so fervently embraced the metro  
in late 2003. Where did he come from? Like many fashion-for-  
ward individuals, the metro was born in Britain. Author Mark  
Simpson, the self-described "skinhead Oscar Wilde," coined  
the term in the mid-'90s to describe a new breed of consumer-  
narcissist. A flattering appellation it wasn't. By the time the  
metro surfaced in the U.S. 10 years later, he was a much more  
appealing character. In four months, the metro went from the  
subject of an offbeat *New York Times* story to a cultural phe-  
nomenon worthy of his own *South Park* episode. Oh yes, and he  
acquired the feminine persona we've become familiar with.

As the *South Park* creators knew instinctively, the metro was  
ripe for satire and snickers. For many straight men, the handle has  
gay overtones. For macho dudes, it spells s-i-s-s-y. And even guys  
comfortable with their inner female are loath to call themselves

ILLUSTRATIONS BY DAN ADEL; (FRAMES) HEMERA TECHNOLOGIES/JUPITER IMAGES; SSPL/THE IMAGE WORKS; JUPITER IMAGES; MARK SYKES/ALAMY; SCIENCE MUSEUM, LONDON/HIP/THE IMAGE WORKS



metrosexual. Consider Mick Malisic. The 32-year-old marketing director is happy to spend \$1,500 for a made-to-measure suit and hang out at the Ralph Lauren shop in Palo Alto, Calif., for 90-minute fittings. When we caught up with him, he had five pairs of \$500 slacks on order. But talk about a reluctant metro. "If I look from the outside," he says, "I guess I'd be [one]."

However imperfect, the metro label reflects real changes in male shopping behavior. Yes, it's true that *Cargo* closed earlier this year, and *Queer Eye* has suffered a ratings meltdown. But don't read too much into that. The '90s, after all, produced the lad mags *FHM*, *Maxim*, and *Stuff*. These publications are the guy variant of *Good Housekeeping* and *Vogue*. They have provided macho camouflage for men to shop without taking abuse from buddies.

The August issue of *Men's Health* magazine (motto: "Tons of Useful Stuff") tells a tale. Two in every five editorial pages hype brand-name products—dietary supplements, clothes, cameras, tortilla chips, grills. That's on top of 100 pages of old-fashioned ad copy aimed at separating the reader from his paycheck. The message seems to be hitting. A study commissioned by *GQ* found that 84% of men said they purchase their own clothes, compared with 65% four years ago. And 52% of retailers surveyed said their typical male customer shopped at a store at least once a month, up from 10% in 2001.

Nowhere have marketers gone after men more assiduously than in the grooming business. This is a natural fit since men have long used aftershave and cologne (perfume, by another name). Moisturizers and skin creams are a small step beyond the male comfort zone. And in many cases, these products are marketed under the health and fitness label. Finally, brands such as Axe have employed a tactic that has worked down the ages: We promise that if you use this product, women will find you more desirable. Not only are grooming sales up sharply, but companies are ex-

## PLAYBOOK: HOW TO TALK TO A MAN

### Risky Business

It's tricky finding a way to reach the metro, retro, and everyone in between



### Stop Boring Him

Miller Lite's much discussed "Man Laws" campaign combines humorous TV spots of men discussing modern etiquette and a complex Web site where visitors average 11 minutes per visit. The new approach, a far cry from its former "Tastes Great—Less Filling" simplicity, was partly a response to concerns that the monotony of traditional beer ads has contributed to an industrywide slump in recent years.

### Keep It Basic

Guys are open to all kinds of things once considered "girly," from pink shirts to face lotion, but they want things simple. A startup called Amenity launched a five-step moisturizing system in glass jars. It even included a badger-hair shaving brush. Guys found it too fussy, and in September Amenity will relaunch with three products, all in durable tubes that can be tossed in a gym bag.

### Get Him Talki

Yes, guys believe in word of mouth, too. British vacuum cleaner maker Dyson reported 75% to 85% of its sales come from personal recommendations. A visit to online review site epininons.com shows guys among the machine's biggest boosters. Naughty humor e-mailing around a Web at Philips Norelco's Bodygroom making the shaver the top on Amazon for two months.

### Don't Fake It

Especially among the young, failing at this is lethal. Favorite brands cater to male teens to mold their world, from the best T-shirts on Thread to painting their own Adidas. They want to have an impact; they're quick to sniff out a such as the widely mocked campaigns by Coke Zero and Bismol, which failed to connect with the hipsters they were cour-

pected to roll out 800 new men-only products in 2006, according to consulting firm Datamonitor, up from 459 four years ago.

## Girl Territory

PIROOZ SARSHAR AND MICHAEL GILMAN have ridden a grooming wave. Eight years ago, and with just \$5,000, the duo started a men's skin-care business. Today they're doing \$4 million a year at two Grooming Lounges in the D.C. area and by selling products over the Web. A typical customer is Greg Gary, who works in sales at recruiting firm Spherion and has regular manicures and pedicures. Gary, 35, felt out of place in unisex spas and salons. Not at the Groom-







**FASHION SAVVY**  
Fitting a custom  
suit at New York's  
Laurie  
Merchant Tailors

ange. "Alcohol—and ESPN on television," he exults. "What more could you ask for?"

et even in a category that has become acceptable to many, it pays to understand that guys don't necessarily respond to come-ons or products that get women swiping their plas-

Metros may be susceptible, but men like Jonas Wanning, a 34-year-old real estate executive who lives in New York, worry about venturing too far into girl territory.

Wanning is what we've chosen to call a modern male. He's into about his skin cream, uses Crest Whitestrips three times a week, and is contemplating a facial. Like many guys of his generation, he is used to sharing the stage with women. They tend to pay attention to their appearance, so men have to, as well. The better you look, the further you get out there," he says. But

Wanning is still a guy's guy. He plays baseball on Sundays and covets a Ducati motorcycle. Wanning recently got his first manicure, but it was a little nerve-racking, truth be told, because the nail shop had a big plate glass window.

The evolution in how men shop and what they shop for goes far beyond the shave and haircut. Men are marrying later, and once hitched they're breaking the old rules. The single male home buyer has traditionally been all but ignored by builders obsessed with married couples and single women. But at the new KB Home development in Cary, N.C., a townhome designed by Martha Stewart Living Omnimedia Inc. is expressly outfitted for single men. With dark wood cabinets, black granite countertops, and stainless steel appliances, it has a big kitchen and oversize dining room. Gray walls, a doublewide shower in the master bedroom rather than a bath, and a higher-than-average sink all nod to the guy they're trying to attract. Of the 28 homes sold since the June 24 grand opening, 11 went to single men.

Thanks to the two-career household and fathers' increasing

interest in raising their kids, men are putting in their two cents when it comes to buying for them. The makers of the high-concept Bugaboo stroller deliberately went after dads, designing a black-and-chrome contraption with a set of tires that wouldn't be out of place on a dirt bike. No kids or tear-jerking moments in Bugaboo International's ads. They focus on engineering and design.

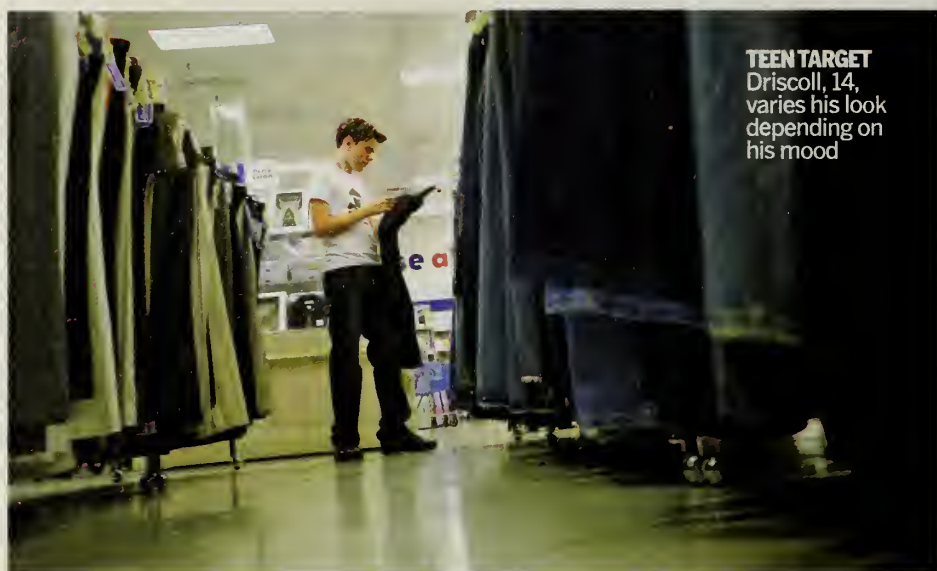
For companies that see all men as potential customers, it's a trick to find a way to speak to the metro, retro, and everyone in between. A safe bet is to play to a guy's inner geek. That's what Dyson did. Its ads focus on the vacuum cleaner's revolutionary technology, while the machine's see-through collection module takes in-store demonstrations to a whole new level. Before Dyson entered the U.S., men barely registered in this

## SHARE YOUR THOUGHTS.

Sun believes sharing is the way to create better ideas. That's why we've teamed up with *BusinessWeek* to offer you an opportunity to share your comments. Join the conversation about this week's Cover Story at [businessweek.com/coverstory](http://businessweek.com/coverstory).







**TEEN TARGET**  
Driscoll, 14,  
varies his look  
depending on  
his mood

category. Today, says the company, 40% of its customers are men, and its machine is the No. 1 vacuum in the land.

For topics even less compelling to men than vacuuming, humor helps. Not exactly the old locker-room variety, but something with a bit more irony. In May, Philips Norelco launched a campaign for the Bodygroom, a \$35 electric shaver designed to remove hair "below the neck." One can only imagine the squirming that went on at Philips' buttoned-down Stamford (Conn.) headquarters about how to, um, position this product.

Ad agency Tribal DDB created a Web site (shaveeverywhere.com) where a guy dressed in a white bathrobe describes the surprising uses to which Bodygroom can be put. Naughty words are bleeped as pieces of fruit resembling certain male body parts pop onto the screen. The clincher: the promise of an "extra optical inch." Guys loved it. Visitors spent 6½ minutes on the site on average and madly forwarded it to friends. For eight weeks following its May 2 launch, the shaver was No. 1 on Amazon's health and personal care category.

## A Room of His Own

NOT THAT THE LOCKER ROOM should be off-limits. Every social revolution begets a backlash, and the unisexing of society is no different. For companies targeting regular guys, pandering to the retro can be highly effective. That's what Burger King did recently with its "Manthem" TV spot, featuring an average Joe spoofing the Helen Reddy classic *I Am Woman*. Likewise, Procter & Gamble Co. has repositioned its Old Spice brand as Old Spice High Endurance (and all that that implies). Its site features a woman in a bikini with the tagline: "When she sweats she's sexy. When you sweat, you stink."

For many men, modern life has stoked nostalgia for their own place—a boys' club, if you will. Smart businesspeople are catering to that urge. One is Joe Grondin, founder of Roosters, a chain of barber shops based in Round Rock, Tex. At Roosters, the plasma TVs are set to the game, the armchairs are leather, and the beers are in the fridge. "Men want a place to go for themselves," says Grondin, by way of explaining how the number of Roosters franchises has doubled to 15 since this time last year. "We got

in touch with our feminine side and learned to cry, and women burned their bras. Now we're back in the same place. We haven't been on this plan for millions of years without deciding who guys are and who girls are."

Clearly selling to today's man is a confounding undertaking. But wait till his grandsons, sons, or kid brothers start tossing their disposable income around. Today's teen males are a little like their forebears. At first glance, Dexter Driscoll seems like a typical 14-year-old. He swims around cross country, listens to the pop band Fall Out Boy, and cherishes classic horror movies. But he's no conformist. Driscoll, the son of a financial adviser in Plymouth, Mass., has no need to conform. He varies his look depending on his mood: preppy one day, boot-camp Levis and T-shirt the next. He is levelheaded and self-assured. Driscoll is what Teen Research Unlimited Inc. calls the mature teen. These kids are more savvy, responsible, and pragmatic than previous cohorts, thanks in part to their boomer parents' tendency to treat them as equals.

It goes without saying that teens have mastered technology. Many picked up their first mouse as toddlers. As a result, says Janice Lee, co-founder of teen researcher Look-Look Inc., it's not at all uncommon for teenagers to conduct the Web research on big family purchases such as cars and electronics. Conservatively speaking, teen boys in the U.S. spend something like \$100 billion each year, but their informal role as in-house shopping consultant amplifies their impact.

Another thing: The interactivity of the Web has fostered them a radical view of brands. They simply don't assign ownership of those brands to the companies that created them. Take a look at YouTube or MySpace.com to see the rip-offs of ads: everything from the Army to Apple computers. "You have to be able to let go," says Kevin George, who runs the \$400 million US Axe bodyspray business for parent Unilever Group. "It's about creating products people want to interact with rather than flashing a 30-second spot in front of them."

The more these teens can alter what they're buying, the happier they are. One of the most popular brands with male teens today is Adidas. The sneaker maker's in-store events, where kids can decorate their own shoes, is a sign the company gets it. A shirt Web store Threadless.com is among the top five sites



## What Kind of Man Are You?

**Quiz:** Find out if you're metrosexual, retrosexual, or ...?

**Slide Show:** Here's how 10 businesses market to men—everything from strollers to plastic surgery.

**Makeover:** The Brawny man gets one.

**Listen In:** Executive Editor John A. Byrne talks marketing to males with Nanette Byrnes in a podcast interview.

**BusinessWeek Weekend:** We put some ads to the test with a couple of male shoppers. Check your local listings or go to [businessweekweekend.com](http://businessweekweekend.com) and type in your Zip Code.

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with teen males, who like the designs but also embrace its democratic ethos. Over 300,000 registered users design, review, and buy the T-shirts, which are produced in limited runs of 1,000.

Big brands don't have the luxury of being built communally from the ground up, but it's especially important for them not to fake their way into acceptance with teens. A recent Coke Zero commercial featuring singers performing on an urban rooftop did O.K. with young men. But it tanked with some teens who found it phony, says Look-Look's Lee. A recent Pepto-Bismol commercial starring breakdancers... well, let's not even go there.

It's going to take most marketers a while to get their mind around this generation's activist approach to consumption, but they're working on it. With 70 million echo boomers in their teens and early 20s, they'd be dumb not to. The metrosexual forced a fresh look at just who the male consumer is, and that will help marketers suss out the next generation. They may have rushed too fast to embrace that self-obsessed guy from Britain, but he taught them there's more to the modern man than a beer-chugging sports nut. Thanks to the metrosexual, marketing to men will never be the same. ■

## BODY WASH CONFIDENTIAL

# Living the Loofah Life, And Loving It

BY BURT HELM

**T**he scene: Saturday afternoon in a messy, rundown apartment in a quasi-hip neighborhood in Brooklyn. Two guys, Max and Burt, lie sprawled on a large sectional in front of the TV. A couple of empty beer bottles are on the coffee table, and a baseball game is on. A third guy, Neil, enters the room. He's carrying a shopping bag.

Before I proceed, let me say that this scene is pretty much every weekend day of my life. I live with three friends from college, all of us in our mid-20s. And while the one girl we room with actually does stuff on the weekend, Saturday for the guys means lying comatose on the couch watching sports, or consecutive episodes of HBO's *The Wire*, or whatever's on. We're not metrosexuals, retrosexuals, hipsters, NASCAR guys, or anything else. We're just, well, average dudes. But this Saturday is a bit different.

So Neil walks in with the bag. Max and I look up. Neil begins to speak. The topic is

bath products. Neil confesses he'd run out of soap and used some of my body wash, and that he'd gone to the store to replace it. I thank him for being so considerate. But Neil isn't ready to put the bag down and watch the Mets. Neil is staring at me.

"That brand of body wash you use, Burt.... It was \$9.25. Just for this little bottle!" He removes the soap from the bag and places it on the coffee table. The liquid inside is a pleasing chestnut color. The bottle is a slender cylinder. The label reads, in slim, scripty letters, Rainbath. It stands there, almost haughtily, among several Yuengling empties.

Neil is still looking at me, perplexed. Why such vanity, Burt? What kind of man pampers himself this way? Max looks

bemused and a little distrustful.

"Whoa! That's crazy!" I say. "I had no idea it cost so much!"

That wasn't true. I knew exactly how much the stuff had cost. A few weeks before, in the CVS drugstore on Court Street, I had spent 20 minutes staring at the wall of soap in choice-induced paralysis. It was one of those moments when you

know the decision you are about to make could determine the rest of your life. If I bought the Rainbath, where would it all lead?

Finally, I plucked it off the shelf and, before I knew it, had picked out a loofah as well. Ever since, I have used the loofah with the Rainbath. Every morning.

Now the question was front and center: Why did I buy it? And, with my roommates eyeballing me, why was I trying

to hide the fact that I'd carefully selected it?

Let me try to explain. When I'm in the soap aisle, like a lot of other guys, I'm running an equation in my head: Which brand will do the best job cleaning me, while not sounding completely girly? Soaps with names like Aveeno Positively Radiant, St.

Ives Oatmeal & Shea Butter, or Pure Cashmere are unquestionably out of the running. On the other end of the spectrum are the "guy" brands, like Axe and Adidas. It's hard for a grown man to take himself seriously using those, unless he's bouncing around nightclubs with a headful of gel or playing a professional sport.

Despite the goofy name, Rainbath struck the right balance for me. And now that I've tried it, it's damn good soap. In the privacy of my shower? I enjoy it. But towed off and clothed? I'll still plead the Fifth.



BURT HELM Lathering up

**The Young Man's Bath Product Anxiety Curve**

The higher the price, the girlier the product. But how clean can you get before guys start to notice?

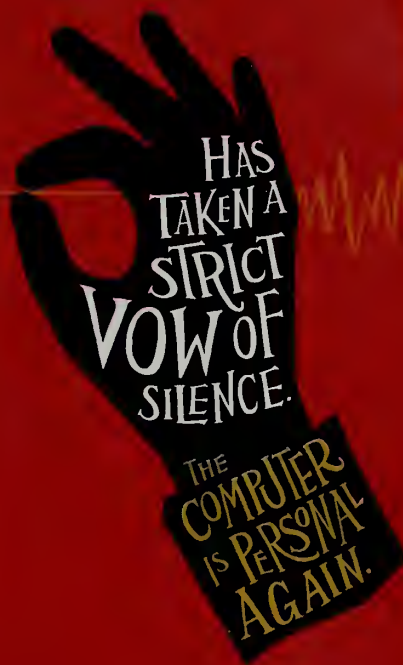
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# Fished

The U.S. fishing industry is sinking as the catch dwindles and a way of life vanishes. But a market-based fix could fill nets again

**By Aaron Pressman**

**IT'S AN UNSEASONABLY WARM JUNE DAY ON THE ALASKAN** island of Kodiak as skipper Dan Miller pulls the Anna D up to a quiet concrete pier beside a seafood wholesaler. The hold of his fishing boat is loaded with 9,000 pounds of freshly caught halibut, and the lanky former biologist is as happy as a seal soaking in the sun. Halibut is selling for almost \$4 a pound, a record, and Miller's gross take will be nearly \$33,000.

Some 4,000 miles to the southeast, Maine fisherman Craig Pendleton, 46, is spending much of the summer sitting in a dark office over Norm's TV in Saco, a former mill town south of Portland, pondering the fishing industry's future. Since early May, his boat, the 54-foot Susan & Caitlyn, has been sitting at a dock collecting barnacles because of federal rules that limit Pendleton to only 48 days at sea. He likely won't go out again until October to trawl for cod and haddock in the Gulf of Maine.

So why is Miller dancing on the docks while Pendleton is moaning in his beer? The short answer is ITQs.

Miller doesn't have to worry that the high-priced halibut will be depleted by other fishermen. Only holders of permits known as "individual transferable quotas" are allowed to catch halibut in the Gulf of Alaska. The 52-year-old Miller holds ITQs giving him the right to catch 45,000 pounds of

halibut. He can use those rights eight months of the year, sell them to others, bequeath them to heirs, or even elect to leave his halibut swimming in the sea. In effect, Miller "owns" those fish.

Today, Alaskan halibut. Tomorrow, Pacific Northwest salmon, Gulf of Mexico red snapper, Atlantic scallops? Surprising as it may be, this controversial free-market system for parceling out individual property rights to fish in the sea may be the future for the troubled U.S. commercial fishing industry. Beset by overfishing and falling catches and battered by imports from Asia, Europe, and Latin America, the old way of American fishing no longer seems sustainable. The result: growing support for congressional action to force widespread use of individual transferable quotas, a radical move that could help restore U.S. fisheries to health and make them more competitive in a global marketplace.

The size of the problem is enormous. Even in the face of ever-tighter rules, the list of overfished species that may never be commercially viable for decades has barely budged. 67 depleted fish stocks a decade ago, 64 remain scarce, despite a law Congress approved in 1996 mandating 10-year rebuilding plans. "Half of these species are still being overfished, even now," says Andrew Rosenberg, a Univer-

A large, stylized graphic of a barbed wire strand loops through the text 'd count'. The strand is dark and metallic, with a sharp point visible. The background is a textured, teal-blue surface.

d count



sity of New Hampshire professor who spent 10 years at the National Marine Fisheries Service, which oversees the industry. "All of the incentives are to get around the rules."

Georges Bank cod won't be back for at least 20 years, according to the Fisheries Service. Canary rockfish in the Pacific won't be at sustainable levels for 70 years, and red snapper for 16. Just this year, the Fisheries Service declared a disaster in Pacific Northwest salmon and an emergency in the New England groundfish that Pendleton chases, leading to dramatic reductions in permission to fish.

Of course not every fishery is doing poorly. New England's scallop industry is booming. A marketing campaign promoting wild Alaskan salmon has created demand for premium-priced fish from the Copper River. And if the new electronics on the commercial boats in Bass Harbor, Me., are any indication, lobstermen are enjoying a profitable season.

But as nets come up emptier and emptier, the irony for freedom-loving fishermen is that the regulatory system most have so far chosen to stick with tries to limit their every move, dictating where and when they can fish and the size of boats, nets, and gear. The rules of commercial fishing, which vary by locale and species, are set by eight regional councils made up of industry, state, and federal regulators, scientists, and environmentalists. The rules are cumbersome and convoluted, and many fishermen exploit loopholes. "Communism isn't dead," says University of Rhode Island professor Jon Sutinen. "Central planning is still thriving in our fisheries management."

It's a classic case of the tragedy of the commons, the economic textbook description of why farmers overgraze on public lands. Each farmer seeks to maximize the benefit of letting his cattle

## Fish Stories

**Next Big Fin?** The rise of barramundi, cousin to Chilean sea bass

**Restaurateur's View:** A talk with Legal Sea Foods' CEO

**Slide Show:** Tracking the catch from ship to shore

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graze. So with no individual incentives to conserve, in the end the grass on the commons is destroyed for all.

The same is true in fishing. Individual fishermen have an incentive to fish as quickly as possible because under the rules in place in most coastal areas, an entire fishery is closed when the total catch quota is reached. "Everyone is trying to maximize their catch," says Harvard professor Robert Stavins, a pioneer in the design of economic solutions to similar problems in air pollution control. "There's no private-property right."

That results in lower-quality product and the ecological harmful practice of discarding "bycatch," fish other than those being sought that are accidentally hauled in. A great many of those fish are either thrown back dead or don't survive. And in the fishing frenzy, boats collectively often exceed the quotas. In New England, long the poster child for limp enforcement, catch limits were set above scientific recommendations for years, and fishermen still blew past them. The haul in 2001, for example, was over 40 million pounds, almost three times the quota.

The diminishing catch has left America's fishing industry vulnerable to two gale-force economic storms. Better air trans-

## Where the Fish Are—And Aren't

### HALIBUT ALASKA

The commercial catch is up by 70% since the early 1990s, when dwindling populations prompted regulators to adopt an individual quota system.

### SALMON PACIFIC NORTHWEST

For 2006, regulators slashed the allowable commercial catch of Chinook and coho salmon by 60% because not enough mature fish have been returning up rivers to spawn.

### ROCKFISH PACIFIC COAST

First declared a disaster in 2000, this slow-growing species won't be at commercially sustainable levels until 2050 or later.

### SEA SCALLOPS NORTHEAST ATLANTIC

The total catch has jumped to more than 60 million pounds from just 12 million in 1998, when some parts of the ocean were closed to fishing.

### ATLANTIC COD GEORGES BANK

Just 1,200 metric tons of cod were caught last year by U.S. and Canadian fishermen, compared with an annual average of almost 18,000 tons from 1978 to 1992.

### RED SNAPPER GULF OF MEXICO

Once-abundant harvests of 10 million to 14 million pounds a year dropped to about 4 million pounds recently. An individual quota system goes into effect next year.







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portation has allowed fish retailers to purchase fresh fish from almost anywhere on the planet. Darden Restaurants Inc., owner of the Red Lobster chain, buys fish in 30 countries. Boston-based Legal Sea Foods Inc. has served Dover sole from the North Sea, cod from Iceland, and haddock from Norway. "Now we can have fish buyers all over the world who see catches come in and hand-pick select stuff at auction," says Roger Berkowitz, CEO of Legal, a restaurant chain started in 1950 that grew out of his grandfather's grocery.

The second storm is the spread of fish farming in Asia, Latin America, and Europe. Aquaculture has massively increased the supply of the most popular foods from the deep, such as salmon and shrimp (page 62). Over 80% of the seafood eaten in the U.S. was imported in 2004 (the most recent numbers available), much of it from shrimp farms in Thailand, Vietnam, and China and salmon farms in Norway and Chile. In 2005, America's \$8 billion fish-trade deficit was the largest among natural-resource products after oil and natural gas. So even though Americans ate a record 12 pounds of fresh and frozen seafood per person in 2004, 20% more than a decade earlier, it's dogfish days for U.S. fishermen: The commercial catch has declined 1% by weight in the same period, or 33% by dollar value, adjusted for inflation; imports have doubled.

One bright side for the men in slickers: Demand has pushed prices up, keeping some in business even with depleted supplies and high costs. The wholesale price of cod rose 44% from 1998 to 2004, halibut 58%, tuna 38%, crab 57%, and bay scallops 220%. "The price is keeping the fleet afloat," says John Our Jr., whose boat, the Miss Fitz, fishes for cod out of Chatham, Mass. "If we had the same price as 10 years ago, we'd all be down the toilet."

Still, as dismal as the outlook seems, one big answer may be in the Anna D's hold. Under the system of individual transferable

**NICE CATCH** Alaska's Miller can take up to 45,000 pounds of halibut almost anytime he wants

quotas, Alaska's Miller is allotted a 45,000-pound share of the overall halibut limit: 53 million pounds. So he can take his boat out virtually any time he wants, avoiding the mania and waste that fishing on designated days encourages. And the ITQs can be bought and sold as easily as old comic books on eBay. That encourages consolidation, improving catches for those who remain. The long-term rights also give fishermen an incentive to not to overfish. "We could have more sustainable fisheries with less risk," says Harvard's Stavins. "Ultimately, consumers would see a decrease in price and greater variety."

**NO GO** Maine's Pendleton is allowed just 48 days a year to trawl for cod and haddock

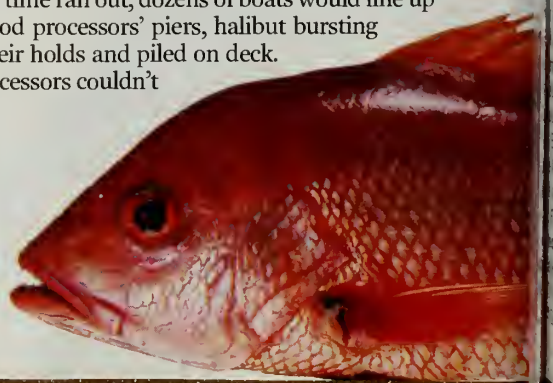
## Success Stories

NEW ZEALAND IN THE 1980s faced a situation even more dire than that of New England today. But ITQs there have brought 80% of the fish stocks back to health, and profits are way up. The same is true in Iceland, parts of Canada, and Australia.

In the bad old days, Kodiak controlled halibut fishing in much the same way as fishing for most species is regulated in coastal areas of the Lower 48. Halibut fishermen could go out only a day or two a year. Before derby day, Miller recalls, harbors were filled with the sounds of saws as boats were rigged for halibut. The sands of vessels were on the water at once, all racing to catch as many fish as possible before the quota limit was hit. In 1988, when his hold and decks overflowing, Miller tossed out mattresses and filled the bunks with fish. Practically limping back to port, he tied up with his back deck partially submerged.

Once time ran out, dozens of boats would line up at seafood processors' piers, halibut bursting from their holds and piled on deck. The processors couldn't

## Red Snapper: Gulf of Mexico fishermen will operate under an individual quota system next year





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handle the volume, so fish lay inside the plants in icy stacks 20 feet high. It took two weeks to process the backlog. Poorly handled and less than fresh, the halibut brought only about \$1 a pound.

The unsafe conditions and waste pressured Alaska's North Pacific Fishery Management Council to search for a solution. In 1995 it introduced ITQs. The new system, adapted from the work of free-market economists, was controversial. Quota shares, handed out on the basis of previous years' catches, could be bought and sold. Those who hadn't fished during the qualifying years, and even members of halibut boat crews, got none.

Hard feelings still linger, but since then, the numbers have been startling. According to the most recent stats, Alaska fishermen caught 77 million pounds of halibut worth \$169 million in

2004 vs. 58 million pounds worth \$85 million just 10 years earlier. This year's catch could exceed \$200 million.

When Alaska's program began in 1995, Miller got some of his share based on his historical catch. He then bought more ITQs for about \$9 a pound. It has been a brilliant investment. Shares now go for up to \$22 a pound. And the price of the high-quality fish brings in has tripled as well.

Unlike other long-consolidated natural-resource industries such as oil, most fishing is still done by owner-operated boats. There is no ExxonMobil of fishing, just lots of Dan Millers and Craig Pendletons. Tyson Foods Inc. learned how elusive profit can be under the antiquated regs during a disastrous seven-year foray into fishing, resulting in write-offs of more than \$200 million.

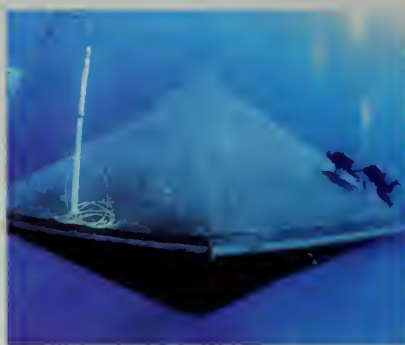
## Six Miles Out, Controversy in a Cage

**O**n an abandoned railroad pier off I-95 in Portsmouth, N.H., past mountainous stacks of rusting junk metal, Rich Langan's vision for the salvation of the American fishing industry slowly rises. To a landlubber—or just about anyone else—it looks like a huge red fish net, 35 feet high, attached at top and bottom to rings made of steel and plastic piping. But this is much more than the mother of all nets.

It's a contraption drenched in controversy because Langan, director of the Open Ocean Aquaculture Project and a professor of zoology at the University of New Hampshire, believes he can use it to farm depleted species like Atlantic cod. Dressed in a T-shirt and shorts and puffing on a cigarette, the deeply tanned professor looks more like the fisherman he used to be than an academic who has become a lightning rod for criticism of efforts to establish offshore fish farms, a move environmentalists deride as fraught with risks for marine life.

"It's bigger than I thought it would be," Langan muses as a crane lowers the 65,000-pound cage onto the pier so staffers on the project can make adjustments before it's dropped back in the water and towed to a fish farm six miles out. The 30-acre site, staked out in 1999 with permission from state and federal authorities, is intended to be far enough off the coast to avoid conflicts with lobstermen and recreational boaters.

The aim of the federally funded project is to learn how to raise species like cod at a low cost and without harming the environment. While salmon and catfish have proved simple



to breed in onshore farms, more sensitive sea creatures such as cod and halibut have resisted aquaculture.

Unlike prior fish cages at the site and in use in Europe and Hawaii, Langan's new "farm" can be raised or lowered to different depths while loaded with young fish. That allows more flexibility to adjust conditions. And at harvest time, the cage can be slowly brought to the surface, keeping the cod in top condition for market. Last year some 1,100 fish weighing about two pounds each were harvested live and sold, but it took hours to raise the smaller cage in which they were confined, and 10% still died in the process.

The new prototype cage is attached with polysteel lines to heavy anchors on the seabed, and on an inspection visit a couple of weeks later, it hasn't yet been filled with fish and submerged. It bobs just below the surface with only the top ring and a few red reflectors revealing its presence. Once at the site, Langan gets video feeds from cameras

### SEA FARM Can all wild species be raised?

attached to the earlier cage already in place. Some 50,000 two-year-old cod swim wildly about when they hear the noise of the boat's engine, then move lazily toward a feeding tube when a computer-controlled buoy on the surface starts releasing pellets made of fish meal, vitamins, and minerals.

A diver on the project clammers atop the swaying bright-yellow buoy, which weighs 20 tons, to refill its hold with 75-pound sacks of the pellets made by Cargill Inc. Instructions on the bag come first in Spanish, since Cargill's prime customers are Latin America's giant fish farms. Critics of farming argue that it takes three or more pounds of meal, made mostly from small fish like anchovies, to produce one pound of salmon. "The amount of meal needed is enormous," says Zach Corrigan, staff attorney at Food & Water Watch, a spin-off of Ralph Nader's nonprofit group Public Citizen. "Would we want to start raising tigers for food?"

But there's no harm to the small species, Langan says. About the same number of small fish for meal are being caught each year, but more are going to fish farms and fewer to feed chickens and hogs. Farmers on land quickly find alternatives when fish meal prices rise. Research is under way to find nonfish proteins for the cod. "Otherwise, there is some limit to growth of aquaculture," Langan says. Already, tilapia raised in South America eat a vegetarian diet, and barramundi growing at an indoor farm in central Massachusetts dine on mostly soy meal.

The UNH farm is carefully monitored for its effects on the surrounding ocean ecosystem. Opponents fear that concentrated waste from the caged fish will harm other marine life and that escapees will damage the gene pool of wild fish. "We've seen no environmental impact or fish freedom," Langan says. Doubters also argue that successful fish farming largely depends on cheap labor. Langan points to Norway and Canada, where wages are high. "If they can do it and be competitive, why not the U.S.," he asks. And Norway is already working on cod farms, too.



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## Salmon: The U.S. Fisheries Service has declared a disaster in Pacific Northwest salmon



lion. Tyson had expected individual quotas would be introduced broadly back in 1992 but didn't count on the depth of resistance. "You're giving away a public resource," says unconverted Kodiak fisherman Shawn Dochtermann. "If our forefathers were still around, people would be hanged at the gallows for this."

New England fishermen like Pendleton remain opposed, too, fearing the rapid consolidation that could occur if big companies like Tyson can buy up quotas. Corporate operators would downsize the fleets, obliterate the towns that rely on them, and turn owner-operator fishermen into employees with little say, he says.

That may not be just idle speculation. In March, Pendleton went to New Zealand and came back unimpressed. A handful of companies own more than 70% of the fishing rights. "It's a purely economic model with no social considerations," he says. "I don't see how it can work for New England fishing communities."

But there are ways to address Pendleton's concerns. In Alaska,

communities can buy ITQs and lease them to local fishermen, thus maintaining their culture. A congressional study of all such programs also recommended caps on the number of shares any one person or company can accumulate.

And more and more, doubters like Russell Underwood, who chases red snapper out of Panama City, Fla., are starting to come around. Underwood felt he had no choice but to head out in choppy and debris-filled seas last October, just days after Hurricane Rita hit. With the red snapper fishery in the Gulf of Mexico open only 10 days a month in 2005, Underwood says, "Whether it's a hurricane or your wife's anniversary," you have to go. His boat broke down, and he was rescued by workers from an oil rig. Even Pendleton says: "Down on the docks, I'm hearing a lot of 'Give me my quota and go away.'" ■

## How Mr. Cod Sees It

**MARK KURLANSKY** worked on commercial fishing boats before becoming a journalist, so it's probably no surprise that his writing often focuses on the sea. In his 1997 best-seller, *Cod: A Biography of the Fish That Changed the World*, he traced pursuit of the fish back to the Vikings and chronicled its recent near-demise in the North Atlantic. These days, Kurlansky is researching the plight of fishermen in Gloucester, Mass. He talked with Boston correspondent Aaron Pressman.

**You read everywhere now about the crisis facing New England's fishing industry. Has this happened before?**

It's the nature of fishing to have crises. Gloucester, New Bedford, Point Judith [R.I.]—this is not their first crisis. [These fishing towns] are periodically in crisis from all kinds of things including, as now, bad catches. We don't know if the [current crisis] is because of overfishing or something else. If you look at what has happened to cod in New England over the past 10 years, there hasn't been



overfishing. And yet it's still in trouble. People are beginning to think there are other reasons. I wouldn't be surprised if global warming and pollution played a part.

**Will commercial fishing disappear from New England?**

It's pretty broadly felt that fishing will survive in some form. When you look at the records of New England fishing vessels...there have always been these periods. It's a classic thing. Midwater fish hang around for a while and then disappear. In the Middle Ages when the herring left, they used to say it was because the town engaged in adultery.

That could be the case with Gloucester.

**Fish farming is booming overseas, but not in the U.S. Could that be part of the answer here, taking pressure off wild species?**

To me, fish farming is irrelevant. The issue has always been to preserve the culture of fishing towns. That's what I'm writing about here: Can Gloucester preserve its identity? There are people who want to turn the harbor into condos and a yacht basin.

**Should regulations, such as using individual quotas, be overhauled to make fishing more profitable?**

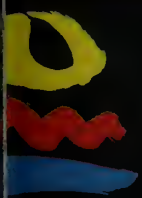
Why don't they just ban dragging or seriously restrict the size of engines and vessels? That would be more effective than all this days-at-sea and quotas stuff. I think we should go back to skiffs.



An abstract graphic featuring a complex network of glowing blue and white lines and nodes, resembling a neural network or a global communication web, set against a dark background.

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**KEARNY** Her online input is helping shape Glaxo's new weight loss pill

# It Takes A Web Village

Private online communities are providing special insights into customers' needs

BY HEATHER GREEN

**J**OINING AN ONLINE COMMUNITY devoted to weight loss has been doubly rewarding for Kathy Kearny. Sure, the 56-year-old met other women who support each other's dieting struggles through instant messaging and chat discussions. But Kearny also has a hand in shaping a major weight reduction product at a pharmaceutical giant. Glaxo-SmithKline PLC, which sponsors the community, is getting tips from Kearny and her friends in a runup to the launch of its first weight loss pill next year. The members answer questions about packaging, offer advice on where to place store marketing, and, most important, frankly discuss their own battles with the scale.

Glaxo says it is gleaning far more than it could have from focus groups. And it has created an intensely enthusiastic

corps of product evangelists. "They have done an incredible job of reaching out into the community and giving us all hope that someone out there cares about us and we are not alone in our struggle to lose weight," Kearny says.

By teaming up with Communispace Corp., a startup that hosts private online communities, a growing group of companies such as Glaxo, Kraft, Hewlett-Packard, and Coty is learning how to use the Web to harness customer input. "When you can get customers to bond around a common set of issues, the quality of the information they give you is so much more accurate and authentic," says Patricia B. Seybold, chief executive officer of market researcher Patricia Seybold Group Inc., who studied the Communispace groups for an upcoming book.

The key is to create real bonds among

community members through individual and group activities. Communispace recruits members of select groups through e-mail ads, whether it's 18- to 24-year-olds for Coty Inc. or photo fans for Hewlett-Packard Co. Members are asked to spend about half an hour each week on five activities, such as uploading pictures of their pantries. In return, they get \$50 gift certificates, sample products, and a chance to have their opinions heard. Communispace moderates the communities, but company marketers and researchers can monitor the activities and jump into discussions.

## NOURISHING INFO

INSIGHTS FROM THESE communities don't replace traditional market segment research or statistical surveys, says Dia Hessian, Communispace's president and CEO. But they can shake up the traditional top-down approach to product development. When Kraft Foods Inc.'s Nabisco group was brainstorming about new kinds of dieting and healthy products three years ago, it asked online participants what diet food represented to them and how they made choices when they snacked. Kraft learned that customers didn't feel they needed to deprive themselves of a diet—what they really wanted was the ability to control how much they ate. Kraft obliged with 100 Calorie Packs, a line of small, one-person bags of Oreos and Ritz crackers. The results were stunning: Last year that product line racked up \$100 million in sales.

Discussions in Glaxo's community helped shape the advertising and packaging for the company's new diet pill. It also underscored the confusion around dieting. In one exchange, a member stated that you could lose weight by drinking eight glasses of water a day, while another said no, it's eight quarts. A third added that the water doesn't count if it's in coffee, but was quickly contradicted.

Because members come to trust one another, feedback can be unexpected. When Glaxo asked the group to use images to show how they felt about themselves, the women posted photos of hippos and elephants. Says Andrea Harkins, senior search manager at GlaxoSmithKline Consumer Healthcare: "These are things they wouldn't have said in words." ■



**BusinessWeek online** For a podcast about Kraft's efforts, go to [businessweek.com/mediacenter/podcasts/webSMART/current.html](http://businessweek.com/mediacenter/podcasts/webSMART/current.html)



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# Taking Brands To the Bank

Why Bob D'Loren is stitching together a patchwork of consumer trademarks

BY EMILY THORNTON

**O**N AUG. 21, ATHLETE'S Foot Brands became the latest global franchise to be gobbled up by financiers. But it wasn't a private-equity firm or hedge fund that bought the sneaker retailer for \$52 million—it was a small publicly traded company called NexCen Brands Inc., run by ambitious former investment banker Robert W. D'Loren. His goal: to cobble together an empire of widely recognized consumer companies based on the strength of their licensing. "I envision us to be the world's premier brand owner and manager," he says.

Others seem to share his vision. D'Loren merged his investment banking boutique, UCC Capital Corp., into financial company Aether Holdings Inc. and announced his brand-baron aspirations on June 7. Since then, major hedge funds such as D.E. Shaw, Ramius Capital Group, Soros Fund Management, Pequot Capital Management, and Citadel Investment Group have poured into the stock, sending it up 48%. (With the Athlete's Foot deal, Aether changed its name to NexCen.)

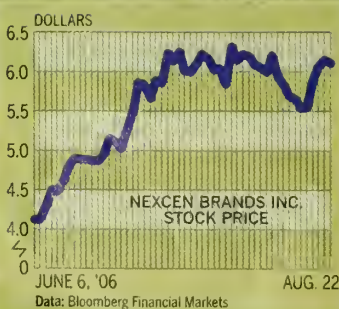
Athlete's Foot was first on D'Loren's agenda because of its reach, which spans 40 countries. D'Loren plans to transform the chain into a splashy sports-lifestyle hub by developing consumer brand products to sell through the franchise—much like Starbucks Corp. now sells everything from coffee to DVDs. But D'Loren isn't stopping there.



From his office atop a skyscraper in midtown Manhattan, inside the former executive suites of onetime sprawling conglomerate ITT Corp., he recently ran through a three-page-long list of targets.

**D'LOREN** His \$700 million shopping spree is under way

## EMPIRE BUILDING



The plan is risky. D'Loren will try to parlay \$130 million in cash on NexCen's balance sheet into a \$700 million-or-so shopping spree, tapping the company's equity and taking on more debt to write the checks. But if his plans for fixing up companies don't gel quickly, all bets are off.

Still, D'Loren, the son of a stone mason

from Long Island, has built his career on bold ideas. Back in 1999, while he was running UCC Capital, he dreamed up a new way for fashion designers like Bob Blass to raise money. Traditionally, they got financing based on their inventories. D'Loren told them they could raise money by bundling up their annual trademark revenues and selling them to investors. Other apparel designers and retailers quickly lined up. His approach was considered so unique that "I once described [D'Loren] to someone as the Michael Milken of trademark financing," says Carlos de la Renta Ltd. CEO Alexander Bolen, referring to how Milken pioneered the junk-bond market for struggling companies in the 1980s.

D'Loren's latest notion is that garment makers should outsource their manufacturing and become pure licensing businesses. He recently advised Neil Cole, a younger brother of shoe designer Kenneth D. Cole, on a string of acquisitions that transformed Cole's teen-shoe maker Candie's Inc. into a diversified apparel license outfit called Iconix Brand Group Inc. He also advised on Iconix' purchases of jeans maker Mudd (until this year) and dress designer Badgley Mischka in 2003. Since the Mischka deal, Iconix' stock price has zoomed 230%.

D'Loren has also attempted to raise money for music composers by securitizing their copyright revenues, with mixed results. He issued a Nashville-based performing-rights organization in 1999 in raising \$29 million. But he was sued by songwriter Annie Roboff after an attempt to raise financing for a songwriters' collective fell apart in 2004. According to a complaint, Roboff claimed she was fraudulently induced to transfer title to a number of her songs to the group, which then failed to manage them properly. The case has not yet been settled. "It was fortunate, and I hope it will be resolved," says D'Loren.

Meantime, D'Loren is thinking about applying his approach to other industries, such as restaurant chains. "If you think about it," he says, "the intellectual property of restaurant franchises shouldn't be that different."

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# New Enterprise Piles On the Risk

The once-stodgy VC firm is gambling on money-losers and unproven technologies

BY TIMOTHY J. MULLANEY

**D**URING THE BUBBLE, New Enterprise Associates was the Oldsmobile of venture capital. As rivals made billions on sexy e-commerce plays like eBay Inc. and operated with a half-dozen partners, NEA's big hits came on lower-profile companies such as 3Com Corp. and UUNET Technologies Inc. And with a staff of 45 investment pros, huge by Silicon Valley standards, NEA's rep was like IBM's: smart and consistent, sure, but also slow and not too innovative.

No more. Last month, NEA announced a new \$2.5 billion venture fund, the largest in its 28-year history and the second-largest the industry has ever seen. More surprising is that NEA will spend up to half of it on high-risk deals most VCs spurn: mega-investments in money-losing businesses, many of which haven't gotten their technologies to work yet. Some of the money will prop up cash-burning public companies that can't otherwise raise capital. In other deals, NEA will acquire unproven drugs—many with U.S. regulatory approval still years away—from Big Pharma outfits and build startups around them. “We’ve expanded the definition of what we do,” says NEA man-

aging general partner Peter Barris, a former GE Information Systems executive.

Already, NEA has put \$25 million into the first round of funding for CoGenesys Inc., a spin-off from Human Genome Sciences Inc. that's developing drugs for heart failure and white-blood-cell disorders. NEA's money was part of a \$55 million financing, 20 times what a Web media startup might raise so early on.

This is swashbuckling stuff. If a company's technology is unfinished or hasn't landed customers, a VC firm usually puts up only a few million dollars initially. That approach shoulders what VCs call “technology risk” while minimizing financial risk. When VC outfits make big bets, they usually insist the technology be finished and the company be cash-flow positive. The size of the investment adds

financial risk, but only after technological risk is resolved. NEA's fund is unusual because it takes financial and technological risks at the same time. “I think it's definitely new,” says Josh Grove, an analyst at VentureOne. “We haven't seen anything quite like what they're doing.”

Why do it? Partly because of the meager initial public offering market. Of 29 venture-backed companies went public in the first half of 2006, down from 100 in early 2004, the only strong IPO year since 2000. To generate returns, NEA must take more chances. It has recruited managers from IT and life-sciences industries, including ex-Guidant Co. chairman Jay Graf, and says it can manage tech risk with big dollars at stake. “We don't have exactly the right person to understand an idea, that person is not more than a call away,” Barris says.

## ACCESS IS EVERYTHING

NEA WAS ABLE to sell the concept to institutional investors who put up \$2.3 billion mostly because of its old reputation. “They have a lot of [industry] expertise,” says Thaddeus I. Gorman, managing director of Abbott Capital Management, which advises institutions on private equity deals, “and tier firms like that get access to the deals.” Erik R. Hirsch, chief investment officer at adviser Hamilton Lane, says NEA can hedge risk across an 80-portfolio well enough to be a top performer. “We'll take risk, but we'll be compensated for that risk,” Hirsch says.

Still, the idea of taking big chances on unproven technologies makes some risk-shake their heads. TA Associates Inc. does large, late-stage venture deals but avoids tech risk and major gambles on money-losers. “We do transactions like that—mistake,” says TA CEO C. Kevin Land.

But the weak IPO market is making rethink tactics. Oak Investment Partners has a similar strategy for a new \$2.6 billion fund. For better or worse, NEA's attitude toward risk is catching on. ■

## Bigger and Bolder

Venture giant New Enterprise Associates is swinging for the fences

| YEAR | NAME OF FUND | SIZE          |
|------|--------------|---------------|
| 2000 | NEA X        | \$2.3 billion |
| 2002 | NEA XI       | \$1.3 billion |
| 2006 | NEA XII      | \$2.5 billion |

DATA: Venture Economics/National Venture Capital Assn.



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# A Big Blue Feeding Frenzy

Rapid-fire acquisitions have made software IBM's fastest-growing business

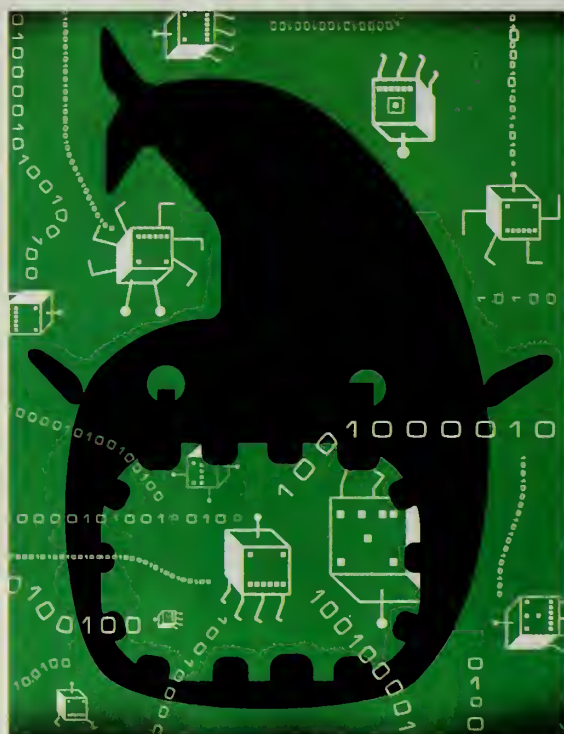
BY STEVE HAMM

**A**FTER NEARLY FIVE decades of thinking of IBM as the world's No. 1 computer company, most people are just getting comfortable with the idea of calling it a tech-services outfit. Well, it turns out that label doesn't fit so well, either. It fails to recognize the huge boost that IBM is getting these days from its \$16.8 billion software division. IBM has long been second only to Microsoft Corp. in the world software business, but only recently has that part of the company emerged as its most reliable growth engine. "Software is not only the fastest-growing but also the most entrepreneurial and the most profitable part of IBM," says Robert Djurdjevic of Annex Research Inc.

That point has been driven home in the past few weeks by a rapid-fire series of software acquisitions. On Aug. 23, IBM announced plans to buy Internet Security Systems Inc. for \$1.3 billion. That follows its \$1.6 billion purchase of document-management software maker FileNet Corp., a \$750 million deal for MRO Software Inc., and a smaller deal for Webify Solutions Inc. All together, those four companies could add 4% to 5% to IBM's annual software revenue. Even before this, IBM was a steady buyer of smaller but fast-growing software outfits—more than 30 software companies in the past 3½ years.

## A TIPPING POINT

IBM'S MASTER PLAN is to use the acquisitions to tap new software lines while milking its mature products for profits. The company already has a broad lineup, ranging from databases and collaboration software to packages for powering Web sites and integrating applications.



At the end of last year, the faster-growing segments of the business, including collaboration and systems-integration packages, accounted for 52% of overall software revenues. To Steven A. Mills, senior vice-president for software at the Software Group, that means the business reached a tipping point that will allow it to speed growth in the future. "The underlying fundamentals of the business are now giving us the ability to deliver a sustained better rate of growth," he says. "This happened very gradually at first, but now it's showing its effects."

IBM has shown that it can turbocharge sales at the companies it purchases by selling their products through its 11,000-strong software salesforce. Its 2004 acquisition of Candle Corp., a maker of computer-systems management software, resulted in a 25% sales increase for that company's products last year.

## POWERFUL ENGINE

EVEN SO, THE SOFTWARE Group's goals are quite ambitious. Mills aims to expand software 6% to 9% per year, with new acquisitions contributing 2% to 3% of the growth. IBM CEO Samuel J. Palmisano had better hope Mills succeeds: Already, his unit is propping up the rest of the company. Software revenues of \$4.2 billion in the second quarter increased a healthy 5%, while the overall company grew just 1%, and services revenues were down 1%. That was the fifth quarter in a row in which software revenue outpaced both overall growth and services growth.

Just as important is software's outsized contribution to profits. Annex Research estimates that for 2006, software will account for 20% of IBM's revenues but 37% of its profits. Services, which represent 53% of revenue, account for 35% of profits.

IBM's \$91 billion overall revenues have been essentially treading water for the past year. That weighs heavily on its stock, which has been trading in the mid-40s after reaching a recent peak of 89 last December. And Mills works to stoke IBM's fire, he still faces the challenge of goosing sales of older software businesses. Over the past few years he has lost market share to leader Oracle Corp. in database software. That hurts sales of other products, since many of them are attached to the database.

**The overall company grew 1%, software a robust 5%**

Of course, IBM also fuels the service side when it brings new software products. Those sales often include huge service contracts, and customers who buy new software typically spend up to five times as much on service to install and maintain it. Just another reason why IBM is not likely to ease up on its dealmaking anytime soon. ■

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# SOA 101: Essential Advice for Implementing a Successful SOA

HP Principal Consultant Andrew Pugsley discusses the challenges posed by service-oriented architecture and how to address them

**SOA is today's hot topic. Why has it caught executives' attention?**

Organizations are facing two key challenges: one is the ongoing need to reduce costs while increasing efficiencies. The other is an escalating rate of change. The ability to respond to change effectively is a critical success factor for most companies. SOA has captured the imagination of business and IT because it provides an architectural approach that helps businesses reduce operational costs, become more efficient, and respond faster and more effectively to change.

**What is one significant misstep companies make when they move toward SOA?**

Most companies understandably focus on technology, and I don't want to downplay the importance of that. But to successfully adopt SOA across the enterprise, organizations must also consider other areas. The business needs driving SOA must be assessed, for example, and people-related issues — the business culture and ways of working — must be evaluated along with the technology. For SOA to work, program management demands a more iterative, evolutionary approach. Governance helps companies track and control the change. Architecture must be well-managed, and enabling technologies support the overall initiative. Having capable, suitably dynamic operations and management is also key to supporting an evolving SOA environment. Finally, organizations must consider the supply and demand



of IT services — both services supplied to the IT organization, and the service that the IT organization supplies to the user community. Successful SOA adopters consider each of these areas.

**What's the best way to start?**

We recommend starting with a business initiative that will result in significant

change. SOA lets you do that by flexibly integrating new technologies and business processes into your existing environment. HP took this approach with a European insurance company and successfully helped it change the way it interacts with its customers. Subsequently, that change has ripple throughout its market.

**There are so many vendors with SOA offerings. It can be difficult to choose a partner.**

Fortunately, an emerging set of reasonably well-defined standards provides greater freedom in choosing or changing technologies, or merging multiple products or technologies. At HP, we make recommendations based on the ultimate business need — considering the current and potential challenges a customer faces and the related need for services, technologies, and support.

**So there's no one best SOA technology?**

SOA products and technologies are growing at a rapid rate, leapfrogging one another with new capabilities. By not tying too tightly into any one

The best approach is to pick a starting point and move through the enterprise over time, migrating various parts of the business into a service-oriented architecture. Part of that process is making clear judgments about what to move and when to do it. Although every organization can benefit from SOA, the advantage that SOA delivers is not the same across the entire organization. A good candidate for SOA is any area where applications are changing rapidly and the ability to change is compromising business success.

**Is it fair to say that attaining the proper expertise is critical?**

Enterprises embarking on an SOA journey should engage with a service

**There is considerable value in engaging with a partner that can bring the expertise and methodologies that will help you be successful.**

technology approach, organizations can take advantage of these new technologies. It's unrealistic in the current IT environment to expect to get everything you need from just one technology or vendor. SOA makes it easier to accommodate new products or techniques, then focus on services that the business needs — rather than concentrating on what technology to buy.

**Every CIO's nightmare is signing those big checks—especially when the company has a data center full of infrastructure investments. Is there a way companies can use what they have and still reap the benefits of SOA?**

SOA is a journey; it's not something that can be done in a "big bang."

provider that brings expertise and proven methodologies. To be successful, you want a partner that can help you address all of the enterprise domains I mentioned and who can handle multiple technologies with equal skill. Also, you should choose a provider that really acts as a partner — a mentor, if you will. Your partner must help develop skills within your organization that allow you to take on responsibility for effectively designing and managing your SOA. You don't want to be dependent on this provider forever. To avoid that, choose a partner that will share experience, skills, and ideas — and transfer them to your enterprise over time.

[www.hp.com/go/soa](http://www.hp.com/go/soa)

## SOA Management: Foundation for Success

One critical — and often overlooked — requirement for a successful service-oriented architecture (SOA) is building an appropriate management structure. Simple Web-services integration projects may be managed easily, but as SOA projects begin embracing processes, policies, and interactions, more complex and rigorous management strategies are needed.

A comprehensive, effective SOA management approach not only monitors and measures the effectiveness of Web services, it also maps those services to the underlying SOA infrastructure and to the business services being offered. "Proper SOA management moves beyond pure technical considerations and aligns the SOA initiative with the company's strategic business goals," explains Mark Perreira, chief architect for SOA, HP OpenView.

To develop an effective SOA management approach, organizations must choose products, technologies, and vendors that can scale to support the full range of both their current and future SOA needs. To ensure that the solution does not become a technical dead end, companies should look for partners whose products can manage the Web services environment, provide management control at the business service level as it relates to the SOA initiative, and support process management within SOA.

"Companies should view SOA as a transformational mechanism that can help them become a better business," says Perreira. "Yet SOA in itself is no silver bullet. To succeed, you must understand your goals, measure them against the technology execution, and adopt a reasonable approach to architecting a solution, creating services, and developing a technology architecture and direction. Embracing SOA management, including robust governance, will make SOA succeed within the organization."



# Here Comes Mighty Mouse

Logitech has turned the simple point-and-click device into a command center

BY CLIFF EDWARDS

**O**NE ENGINEER, GIVEN the moniker "Teflon Tim" by amused colleagues, spent three months scouring the Far East to find just the right nonstick coatings and sound-deadening foam. Another spent hours taking apart wind-up toys. Others pored over the contours of luxury BMW motorcycles, searching for designs to crib. They were members of a most unusual team that spent thousands of hours during the past two years on a single goal: to build a better mouse.

Logitech International's \$99 "MX Revolution," which hit consumer electronics shelves on Aug. 24, represents the company's most ambitious attempt yet to refashion the lowly computer mouse into a kind of control center for a host of PC applications. The sheer scope of the secret mission—which crammed 420 components, including a tiny motor, into a palm-sized device that usually holds about 20—brought together nearly three dozen engineers, designers, and marketers from around

the globe. "Our business is about the last inch between people and content and technology, and the mouse has always been the icon of that last inch," CEO Guerrino De Luca explains.

Part of Logitech's strategy is defensive. Once content to design mice, keyboards, and other peripherals for PC makers to slap their own names on, Logitech over the past half-decade has increasingly focused on selling its branded add-on equipment directly to consumers. Some 88% of Logitech's \$1.9 billion in annual sales comes from retail. But the industry

leader is facing strong challenges from Microsoft Corp. and Chinese makers.

That forces Logitech to rely on delivering improvements every two years to entice shoppers. "We think of mice as pretty simple, but there's a pretty aggressive technology battle going on to prove what the mouse can do," says NPD Group analyst Stephen Baker. "The real challenge is proving those technology upgrades are relevant to people."

## REINVENTING THE WHEEL

LAST YEAR, Logitech struck gold with its \$99 laser mouse for gamers, which offered precise tracking on more surfaces and faster response. Even so, the company's engineers and executives were at first skeptical they could deliver a product that substantially upped the ante. "The goal was passing the 'oooooh' test—creating a visceral experience that communicates both performance and luxury," says product leader Erik Charlton.

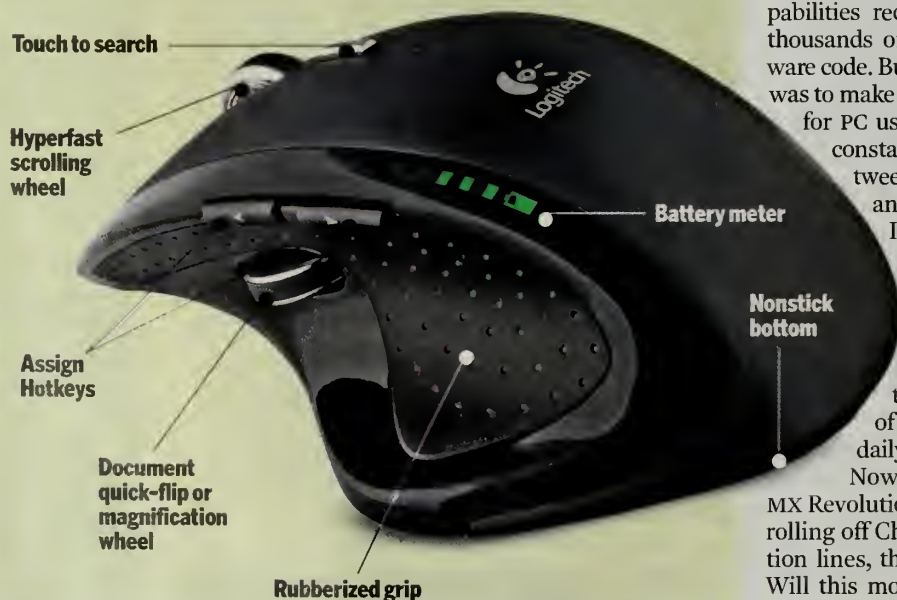
To do that, Logitech literally had to reinvent the wheel. On the MX Revolution, a new plated brass-and-rubber scroll wheel can sense users' intentions based on the type of document they open. It can either zoom through dozens of pages at the flick of a finger or ratchet down, line by line, for slower viewing. A second wheel on the left magnifies or reduces text or can be used to flip between applications. Another button, below the front scroll wheel, lets users highlight text and instantly call up either Google or Yahoo! searches of that text.

Adding all those new capabilities required writing thousands of lines of software code. But the intent was to make things simpler for PC users, who must constantly switch between applications and Web pages. Indeed, company research discovered that users on average finger-scroll through 26 pages of documents daily.

Now, with the MX Revolutions per second rolling off Chinese production lines, the question is: Will this mouse roar to those consumers? ■

## Search, Zoom, and Scroll

Logitech's new \$99 optical mouse uses 420 components vs. about 20 in the typical mouse



**BusinessWeek** online For a slide show on the evolution of the mouse, go to [businessweek.com/extras](http://businessweek.com/extras)



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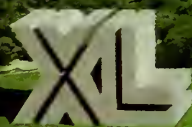
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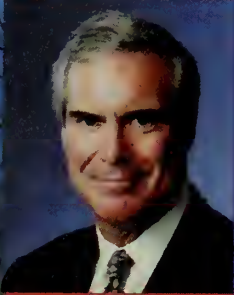


# Reinsurance: the Bedrock

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Donald Kramer  
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On the David Letterman television program two years ago, Dave asked his musical director, Paul Shaffer, if he knew anything about insurance. "No, but I know about reinsurance," Paul quipped. That a bandleader would have even heard of reinsurance, traditionally an invisible pursuit, says a great deal about the way extreme events have propelled themselves into our psyche over the past few years.

Still, the process of insuring risk, when deconstructed, isn't all that complicated. Very few commercial projects get underway without insurance. And very few insurance companies write policies without reinsuring part of the risk. For their part, reinsurance companies accept a share of those risks, and then distribute them further to other reinsurance companies – a process called retrocession. The global reinsurance industry can be seen as a giant economic hazard-control mechanism by which a network of global capital spreads, and thereby blunts, the potentially disastrous effects of risk.

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risks. That increases the chance that any of the companies, and broadly all of them, will be able to meet the day-to-day claims and the occasional enormous insured losses that those who buy insurance can incur.

Measured against its power, reinsurance is the bailiwick of a relatively small number of companies worldwide. Some have accumulated capital measured in tens of billions of dollars and euros and hold assets worth a great deal more. Other companies are smaller, while some are yet-smaller niche specialists who take on specific risks. The combined financial weight of the reinsurers is the foundation on which global commerce stands.

Reinsurance companies operate on every continent, with offices in major cities around the world, where their insurance company clients are to be found. Many of the largest companies have been active in Europe and North America for generations. Lately, a dynamic concentration of reinsurance capital, both intellectual and financial, has developed in Bermuda.

Technology has changed the way reinsurance operates. "In the past decade, the global reinsurance industry has embraced quantitative risk management initiatives and computer modeling techniques that allow them to better deal with the volatility and uncertainties associated with catastrophic events," says Donald Kramer, chairman and chief executive officer of Ariel Reinsurance Co. Ltd., a post-Hurricane Katrina, billion-dollar start-up reinsurer. Kramer successfully started three major reinsurance companies. The use of computer technology is now so great

in this field that computers outnumber staff by as many as 10 to 1 in some companies.

Not long ago, the number of megacatastrophes about which detailed facts were available was limited. Hurricane Andrew in 1992 and the Northridge, Calif., earthquake a year later were the largest. Then came the events of Sep. 11, 2001; the collapse of the World Trade Center produced the largest insured loss in history. After that, in 2004, four named hurricanes hit Florida in quick succession, costing tens of

billions more. Then came 2005 and Hurricane Katrina, which will cost \$60 billion by the time claims are paid, of which reinsurance will have paid half.

The reinsurance

sector survived each of these events. Not every reinsurer stayed in the business, but few, if any, valid claims went unpaid. Thus far, the global reinsurance model has worked.

The reinsurance industry is not, however, perfect, nor is it without its challenges. As a better understanding of risk and its economic consequences has been gained, it has become clear, especially after Katrina, that, for safety sake, the reinsurance model requires some companies to put up more capital for each dollar of premium they write. Many companies have been rearranging their books of business in the wake of these conclusions and of the insistence by the ratings agencies that companies now meet higher capital standards to maintain their reputations.

The basic reinsurance concept has traditionally been "post-event funding." Reinsurers, particularly catastrophe reinsurers, take premiums and invest them until claims following a disaster deplete their assets. The reinsurers then approach the capital markets and offer



shareholders to recharge their war chests. Some companies have taken the opportunity of attracting more capital than was lost, to allow them the ability to write greater volumes of business in the tight market conditions that routinely follow large catastrophes. Another reinsurance model has presented itself: a form of pre-event financing known as securitization, in which bonds are issued against future catastrophe investments or bank commitments. When catastrophe losses exceed stated trigger points, the bonds might be lost — but so far that hasn't happened, despite seven of the 10 most costly catastrophes in history having occurred in the 21st century. Another recent development has been the interest in reinsurance taken up by hedge fund managers. As reinsurers, after Katrina, looked

for ways to take the sting out of some of the risks they carried, hedge fund managers were looking for new fields in which to invest," says Robert J. Cooney, chairman, president, and chief executive officer of Max Re Capital, itself set up in part by hedge fund capital back in 1999.

The result of the meeting of those divergent needs was a series of new reinsurance companies, the "Class of 2005," many of which were owned, in part or completely, by hedge fund managers and, often, their clients.

Curiously, the seismic economic effect of great events is felt most strongly the further down the safety net one looks. Governments nominally underpin all economic behavior and the global financial infrastructure. Reinsurance companies are but one step up, yet they often present

a volatile earnings profile dictated by the low frequency and high severity of catastrophes.

In almost no industry is it acceptable, let alone traditional, for some companies to lose a third or more of their capital once in a while. Yet meeting the costs of a cataclysmic earthquake or windstorm can clobber earnings and sometimes even capital at reinsurance companies. Renewed funding restores their vigor, and the cycle begins anew.

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# Risk by design

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# Kodak Rewrites the Book on Printing

Its new inkjet technology could revolutionize the industry—and revive the flagging icon



WILLIAM C. SYMONDS

THREE YEARS AGO, EASTMAN Kodak Co. stunned investors when it slashed its dividend 72% and said it would use the savings to help fund a huge bet on commercial printing. Shareholders fumed as the stock lost a third of its value in a week. Kodak's turnaround was supposed to be a grand old strategy, but many saw printing as a dead, dinosaur business.

Today, printing could be Kodak's greatest hope for the future. The company reported a \$1.4 billion loss last year, but in 2003 has spent \$2.1 billion to emerge as a big player in the fragmented commercial printing market. And its technology could prove nearly as important an innovation in printmaking as movable type—allowing for mass customization on unprecedented scales.

Competition is rough. In the rapidly changing market for digital printers, Kodak trails well behind leader Xerox Corp., and Hewlett-Packard Co. also has designs on

this business. But Kodak has pulled together a broader portfolio than rivals by picking up everything from the software and plates printers need to get a job started to the presses needed to complete it.

"The global printing industry is just at the beginning of a big digital transformation," says Bill Miller, the legendary stockpicker at Legg Mason Inc. and Kodak's largest shareholder. Since Dale Wettlaufer, a Legg Mason analyst whose father was a printer, sold him on the promise of the business, Miller has become a prominent—and lonely—Kodak bull. Shares trade near \$20, but Miller sees them shooting to \$45 by 2008.

Today, printers make trade-offs. They can use relatively slow digital machines like Kodak's NexPress to create personalized, glossy brochures and other documents. For large print runs—such as *Busi-*

*nessWeek*—they use offset presses, which operate at blinding speed but are difficult and expensive to customize. Since 1998 a Kodak team led by chief technologist Gil Hawkins has been perfecting a continuous inkjet process, code-named Stream, that sprays ink onto paper like a machine gun. It's the best of both worlds: custom digital presses that roll at offset-like speeds, up to 24 miles an hour.

## GETTING PERSONAL

WITH THIS technology, companies like Lands' End could produce catalogs tailored to the buying habits of each customer. Similarly, direct mail could become as personalized as Internet ads. "This could fundamentally change our industry," says Michael R. Murphy, President of Minnesota-based Japs-Olson, one of the biggest printers of direct mail.

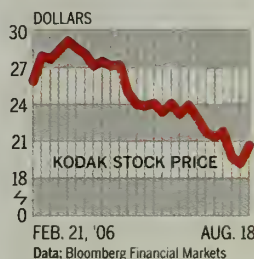
As for mass communication such as magazines and newspaper, both advertising and editorial content could change. Advertisers could do far more targeting of the audience they're trying to reach. Also, readers could tell publishers the sort of content they want; it's not hard to imagine subscribers receiving thousands of distinct printed copies of this magazine.

Problem is, so far Kodak hasn't proved its inkjet technology can deliver the same vivid, crisp colors as offset, cautions Howard Fenton, a consultant at industry trade association NAPL. But it's close enough that James T. Langley, the HP veteran recruited in 2003 by CEO Antonio M. Perez to run the Graphic Communications Group, plans to start commercializing it. "Over the next five years, Stream will become the complete foundation of our inkjet line," Langley says. Some outsiders concur. "No one else has a technology that's as fast or high-quality as Stream," says Frank Romano, a digital printing expert at the Rochester Institute of Technology.

It can't happen soon enough for Perez, who must complete a brutal downsizing of Kodak's film business, find a buyer for its health-imaging unit, and start making money on digital photography. "But we have a real jewel in [digital printing]," he says. He expects the group's operating margins to be 9% by 2008, or nearly twice the ambitious 5% he wants from digital photography. That would be a welcome boost for the flagging corporate icon. ■

## BLUE CHIP BLUES

The printing business may help Kodak shares turn around







## The B-School Of Hard Knocks

One year after Hurricane Katrina, Tulane's Freeman School is back in business

BY GEOFF GLOECKLER

**A**T TULANE UNIVERSITY's commencement in May, Angelo DeNisi looked around at the thousands of graduates, at former Presidents Bush and Clinton, at the other deans and faculty members, and thought: "My God, we made it."

It was only a year earlier that DeNisi accepted the position as dean of Tulane's Freeman School of Business. At the time, he knew he would have challenges, but a Category 3 hurricane wasn't one of them. Neither was laying off more than 15% of the faculty, shutting down two departments, and answering hundreds of calls and e-mails from students placed at other B-schools across the U.S.

Today, one year after Katrina laid waste to New Orleans, the Tulane campus is all new paint and plaster, and only a handful of the B-school's dispersed students have not returned. But DeNisi's challenges are daunting. Among them: getting out the word—to both students and recruiters—

that his B-school is back in business.

When DeNisi took office as dean on July 1, 2005, after 15 years on the business faculty at Texas A&M University, he spent time assessing the school's problems. The curriculum, last overhauled nearly a decade earlier, needed updating. Too few companies were recruiting on campus—only about two dozen visited in 2004, a fraction of the number that recruit at top-ranked schools. "We weren't placing our students," DeNisi says. "People come here expecting to have a job when they leave, not just to be educated."

But DeNisi's to-do list was about to be rewritten. On Aug. 28, Hurricane Katrina slammed into New Orleans, forcing DeNisi and his family to evacuate to Houston. As the city took on water, students fled for higher ground, enrolling at the University of Chicago, the University of Pennsylvania's Wharton School, and

**DEAN DeNISI**  
A lecture hall restored, after the storm's wreckage

other B-schools across the country as part of a deal struck to ensure Tulane students would be able to graduate on time. Suddenly,

school existed only in theory.

One thing DeNisi and his associates had was time. Holed up in a Houston classroom the school rents for satellite executive MBA courses, they redesigned the curriculum, adding a bigger international component and an entrepreneurship program. Says DeNisi: "When people have time to talk, it's amazing what they can get done."

### SIX FEET UNDER

IN THE STORM'S immediate aftermath, much of the Tulane campus was in shambles, including dorms and the recreation center. At the B-school, the main business building was hit hard, with six feet of water in the auditoriums on ground level and mold and mildew growing over walls and ceilings. As crews worked to get the Freeman building up to code, DeNisi got word that programs would have to be cut to deal with the huge financial loss from Katrina, which caused an estimated \$300 million in damage to the university as a whole. In December, 11 faculty members in marketing and operations management—including seven tenured or tenure-track professors—were let go, in what DeNisi describes as the most difficult experience of his first year as dean.

Now, as DeNisi enters his second year, Tulane is nearly back to normal. But enrollment for entering MBAs is way off, down from 90 last year. "Half of the people still think we're underwater," says associate dean Peggy Babin. And with career services director to lead in charge, recruiters haven't returned to campus. DeNisi knows that's unlikely to change until he fills the vacancy.

Oddly enough, the storm that destroyed the Tulane campus may end up as its saving grace. DeNisi is hatching plans to

extend the B-school itself into New Orleans, a place where students will one day learn management techniques in the process rebuilding the city's economic infrastructure. If he succeeds, the educational experience that results will be unique. "This isn't a simulation," he says. "This is real life." ■

### THE STAT

**\$300**

Amount of damage, in millions, to Tulane University by Katrina



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# The New Art Sharks

Upstarts with thick wallets are jostling the old guard in the contemporary market. **BY THANE PETERSON**

**N**EW YORK REAL ESTATE BARON Aby Rosen slips out of a late afternoon meeting for a quick tour of the art collection on display at Lever House on Park Avenue, one of his 32 properties. In the conference room, a couple of Warhols (he has more than 80) and a funky Tom Friedman sculpture made of old cartons. Out in the lobby, an oddly mundane Jeff Koons installation of 30 new basketballs in a glass case. Down the hall, some big oils painted collaboratively by Warhol and Jean-Michel Basquiat. Also on display: works by sculptors Gary

Hume and Louise Bourgeois and Christopher Wool painting.

It's a dream collection, a mixture new and not-so-new artists whose prices have increased three, five, and even sometimes in recent years. Yet Rosen is blunt about how much all this art is worth. "Maybe 30 or 40 million bucks," he says. "I never think about that. It's just part of the environment, part of what I live with every day."

Every age of wealth has its mega-collectors who help set taste and stock prices with the art of the era. And in this era it's increasingly upstarts such as German-born Rosen, 46, who moved to New York 20 years ago after having founded the family real estate company in Frankfurt since his teens. In the last few years you can track the new names creeping into *ARTnews* magazine's annual list of the world's top 200 collectors: U.S. hedge funds, real estate, and media barons, fashion retailers, German advertising executives, and French money managers mixing with the old guard, such as Los Angeles philanthropist Eli Broad. Most among the new generation share Rosen's insouciance about spending enormous sums for works they really want. "I don't think of them all 'hedge fund guys,' but what they really are is people who've made a ton of money very fast," says Miami hotelier and veteran collector Donald Rubell.

Many of them may also be riding the old rules and, as the newcomers don't always play by their day jobs, they're taking huge risks. Their wealth has allowed them to throw muscle to the top many dealer lists and to buy at lofty top auction prices when they can't get enough from galleries.

Yet many are chasing the same trendy art and driving up prices unsustainably fast. Works once coveted work by New York photographer Richard Prince or the Los Angeles multimedia artist Mike Kelley. They're up fivefold more in recent years. Prince's works now cost \$1 million, and hedge fund manager Ilya Ganek is one of two investors who paid \$688,000 for a copy of a 1991 celebrity photo series a

## Adam Lindemann

He collects everything from Papua New Guinea bone daggers to African fetish dolls, but his passion is cutting-edge contemporary art works, such as the painting behind him by up-and-coming German artist Andre Butzer, that have yet to catch on with other collectors.







## Aby Rosen

In a decade, the real estate mogul has acquired a collection of more than 400 works. He has more than 80 Warhols, including the portrait of native American activist Russell Means that hangs behind his desk, as well as eight paintings that Warhol did with Jean-Michel Basquiat. "A million here, a million there," he says. "After a while, it adds up."

York auctions in May. Paintings by enarian artist Tyeb Mehta have had a ar runup in just three years, to as a as \$1.6 million, partly because New hedge fund manager Rajiv Chaudhri buying works by Indian artists whom believes have "been touched by mag- And don't even ask about Beijing- Zhang Xiaogang. Contemporary ese art is the trend du jour, so prices s work have climbed maybe twenty- n 18 months, topping out at nearly \$1 on in March.

le fierce bidding has some longtime tors buying less or focusing on ger artists. Hollywood producer Valentine, a long-established collec- erides some new buyers as "hedge- dim bulbs" and gripes that "you can't

collect in depth anymore unless you're a billionaire." But others are paying the price to stay in the game. Dealers figure that art world heavyweight Ronald Lauder recently anted up \$135 million for a 1907 portrait by Gustav Klimt, probably the highest price ever paid for a painting, because he feared what would happen if the work went to auction.

## BOOM MENTALITY

EVERYONE KNOWS it can't last. Art-price.com, which tracks auction results, figures prices in the U.S. now stand 44% above their mid-1990 peak, just before the last crash. Worldwide, 454 works exceeded \$1 million at auction in the first half of this year, up from 130 in the same period of 2003. Yet the buying continues,

fueled by boom-time thinking. Rosen, for instance, says he isn't worried about having paid \$2.7 million recently, nearly seven times the 1999 price, for a kitschy Koons sculpture of the comedian Buster Keaton. "If you own 12 other Koons, as I do, [paying a high price] makes you happy," he says. "You're just beefing up the value of your other pieces." That's why dealers pursue veterans like Rubell and Vail (Colo.)-based Kent Logan, an early buyer of Chinese contemporary art, trying to buy works in their collections. "The sums are astronomical," says Rubell. "Dealers offer us a good price, and when we say no they offer to double, triple, quadruple it. Maybe it's stubbornness, but we always refuse."

Not all longtime collectors do. The Big



(L-R) CHRISTIE'S IMAGES LTD. 2006; SOTHEBY'S; CHRISTIE'S IMAGES LTD. 2006

Kahuna among the hedge fund guys is Stamford (Conn.)-based Steven Cohen, who art world insiders believe has spent at least \$500 million in six years of collecting. He has bought a Jackson Pollock from Hollywood's David Geffen (for \$52 million, according to *The New York Times*) and a van Gogh and Gauguin from casino operator Steve Wynn (reportedly for more than \$100 million). Lately, he has turned his attention to post-World War II works, says Sandy Heller, one of his main art advisers, partly because great Impressionist and modern pieces are scarce.

## ROTTING INSTALLATION

COHEN IS SNATCHING up some of the best contemporary pieces. Last year he paid London ad mogul Charles Saatchi \$12 million for a 1991 installation by Britain's Damien Hirst that consists of a 14-foot shark pickled in formaldehyde, believed to be the highest price ever paid for a work by a living artist. Trouble is, the shark has deteriorated, so Cohen is getting Hirst to refurbish the piece. Paying millions for a rotting shark may seem wacky, but the purchase played in the art world as a major victory for New York's Museum of Modern Art over London's

Tate, the thinking being that Cohen will give the shark to MOMA. Heller calls the work "a masterpiece" and says MOMA is one of several institutions Cohen would consider if he decided to give it away.

Pickled shark isn't particularly outrageous by today's standards. One of Rosen's more in-your-face treasures, displayed in the Lever House courtyard, is a 35-foot painted bronze sculpture by Hirst of a naked pregnant woman with half her skin flayed off and a fetus hanging from her womb. Rosen paid \$2.5 million for it two years ago.

Bizarre as some of the works seem, the collectors are making a wager almost as old as art: That the greatest works often seem strange in their own time and the challenge is to pick the ones that will last. "You get to play your personal vision against art history, and if something becomes more valuable, in a sense it vindicates your judgment," says Adam Lindemann, 45, a major collector and author of the new book, *Collecting Contemporary* (Taschen, \$29.99).

## Big-Money Magnets

Photos by American Richard Prince and art from emerging nations are on many top collectors' shopping lists.



**Now it's dead.**



Walgreens



Longs Drugs



Schnucks

ECKEYD

GIANT

Tops





# Trade No. 120

GANG

ing from the artist's  
eries sold at auction  
\$1 million in March.

# d (Cowboy)

ANCE

photograph of an image  
fetched \$1.2 million  
e's auction last November.

sura

ajiv Chaudhri paid \$1.6 million  
this painting. The previous  
Mehta was \$317,500.



Truth be told, most of this art will end up in museums, many built by the collectors themselves. For instance, Russian banker Peter Aven, 51, who has assembled one of the world's best collections of late 19th and early 20th century Russian art, says he hopes one day to build a museum in Russia modeled on New York's Frick Collection, founded by steel baron Henry Clay Frick.

In the meantime, everyone wonders how the newcomers will react when the market finally heads down. Some already appear to be taking profits. Hedge fund manager Adam Sender, 37 (sendercollection.com), is selling part of his collection this fall, including works by such top-dollar trendsetters as Prince, Kelley, and Germany's Andreas Gursky. Todd Levin, Sender's curator, says Sender is just rejiggering his holdings and intends to continue buying art "for decades to come."

Still, most of today's big buyers have never seen a bear market—only 39 collectors in *ARTnews'* current Top 200 were on the list in 1991—so Rubell has his doubts about their staying power. "We'll see what happens when things go into the crapper," he says. "The true collectors will be the ones who keep buying art." ■

**Now it's not.**



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**For maximum talk time, use Energizer e2® Lithium batteries.**





# Over the Madding Crowds

Navigating the options for private air travel

BY CHRISTOPHER PALMERI

**Y**OU'RE FED UP WITH higher fares, declining service, and long security lines. Why not fly private? The business has been on a steady climb in recent years, and the latest round of restrictions on carry-on items and stepped-up security for commercial flights should provide even more lift. As

real estate investor and King Air 200 owner Andrew Segal says, when flying private "you don't have to take your shoes off until you get on the plane." And of course, you take aboard all the lotions and potions you like.

But sorting out the various plans can be almost as tedious as inching your way toward the metal detector. So here's a brief overview of the options.

**AIR TAXI** Startups such as Linear Air and DayJet offer charters to certain cities. (Think of the air taxi as a hybrid that combines features of both charter and scheduled service.) By focusing on a few markets and filling empty seats with other passengers, these companies can offer the cheapest rates. Linear, for example, flies from New Jersey's Teterboro Airport to Martha's Vineyard for \$415 each way. **Bottom line:** A good choice for relatively short, infrequent hops.

**CHARTERS** Traditionally the most common and economical method, charters are available from hundreds of operators, from Web-based brokers (JetTrip.com, OneSky.com) to independent aircraft owners (twcaviation.com). Hiring a seven-passenger jet can start at \$2,000 an hour, but extras such as fuel surcharges,

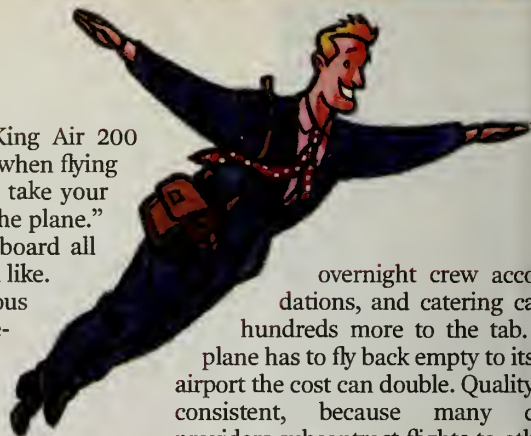
overnight crew accommodations, and catering can add hundreds more to the tab. If the plane has to fly back empty to its home airport the cost can double. Quality is consistent, because many charter providers subcontract flights to other operators. Aviation attorney Ladd Seidman recommends choosing a charter operator that employs its own pilots, trains frequently, and does repair work at manufacturer-authorized service centers. **Bottom line:** Works best for people who fly fewer than 25 hours per year.

**JET CARDS** For \$100,000 you can get a card from Sentient Jet (sentientjet.com) good for flights that start at \$500 an hour. For competitor Marquis Jet (marquisjet.com), the cost is \$116,000 for 25 hours. You don't have to negotiate for each flight, and with Marquis, there are no additional charges for one-way flights. Marquis uses aircraft and pilots provided by fractional-ownership company NetJets, giving it access to some 600 planes. **Bottom line:** A good choice for folks who will use it 25 to 50 hours per year.

**FRACTIONAL OWNERSHIP** The granddaddy of the business, NetJets, charges \$406,000 for a one-sixteenth interest in a seven-seat Hawker 400XP, plus \$6,000 a month in maintenance fees and \$400 per hour of flight time. Tax write-offs and resale values can help offset those costs. Manufacturers such as Cessna, Bombardier, and Raytheon also offer similar plans.

**Bottom line:** Should appeal to people who fly 50 or more hours per year and don't want to bother with maintenance.

**OUTRIGHT OWNERSHIP** NetJets says you've arrived like you own your own jet. But even an entry-level model such as the new Eclipse 500 costs \$1.2 million to buy, \$12,000 a month to keep, and \$400 an hour to fly. Leasing the plane through charter operators can cover some of the expenses. **Bottom line:** This makes sense only for those who fly 100 or more hours per year. But, hey, what's the price status? ■







BY ROBERT PARKER

# Jack of Two Grapes, Master of Both

**BRITISH-BORN** Philip Togni learned winemaking in Bordeaux, and plied his craft there and in Napa Valley before planting his own Napa vineyard in 1980. He produces only two wines: a cabernet sauvignon that can last as long as a great Bordeaux; and Ca' Togni, a sweet red made from the black muscat grape. Like many top California wineries, much is sold via e-mailing list. (Call 707 963-3731 or fax 707 963-9186.) Internet search engines can also help you locate merchants with Togni wines.

## 2001 Ca' Togni

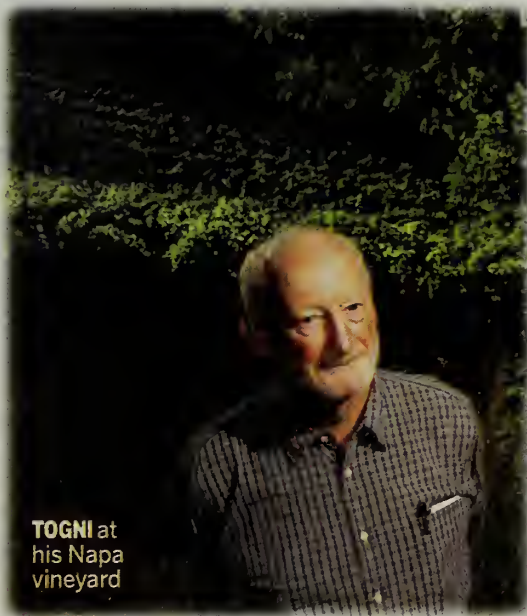
**96 points.** Even with 14.7% alcohol over 20% residual sugar, this sweet wine is not the least bit cloying. An extraordinary perfume of raisins, plums, figs, incense, and Asian spice soars from the glass, tempered by a sweet, gloriously pure acidity that is relatively light on its feet. It's a decadent glass of wine that is enjoyed at the conclusion of a meal. Drink in the next four to five years. \$50 for 375 ml

## 2001 Cabernet Sauvignon Estate

**96 points.** A top effort for the vintage, this wine exhibits a saturated ruby/purple color and a perfume of cassis intermixed with hints of cedar, spice box, dried leather, new saddle leather, and subtle tobacco. It is medium- to full-bodied, with a wonderful up-front sweetness. It does not possess the weight and length of many great wines, but it is surprisingly rich, powerful, and concentrated. Anticipated life: 2005-2018. \$80

## 2004 Cabernet Sauvignon Estate

**96 points.** Tasted from the barrel, this is a vintage for Togni. Inky/blue/purple-colored with a glorious perfume of crème de cassis, graphite, and a hint of black olives, it is medium-bodied and rich with silky tannins. Those



tannins give it more accessibility than most young Togni cabs. \$85

## 2003 Cabernet Sauvignon Estate

**95 points.** An inky/purple color is accompanied by classic aromas and flavors of crème de cassis, black currants, blackberries, dried herbs, smoke, barbecue spice, licorice, and tapenade in this full-bodied, pure, concentrated 2003. It requires another seven to eight years of cellaring, and should last for three decades or more. \$85

## 2001 Cabernet Sauvignon Estate

**96 points.** Inky/black, and the nose offers up spectacular aromas of melted licorice intermixed with crème de cassis, acacia flowers, roasted meats, tapenade, and subtle pain grillé. Opulent and voluptuous, with huge body brilliantly balanced by sweet tannin and adequate acidity, this cabernet possesses impeccable equilibrium, admirable purity, and a 50-second finish. It is one of Togni's great cabs, of which there have been many over the last quarter of a century. While masochists might enjoy it young, I would opt for cellaring it four to five years, and drink it over the following two decades. It is a brilliant achievement! \$140

## 1995 Cabernet Sauvignon Estate

**96 points.** A classic that turns to Bordeaux for elegance, structure, and complexity, yet retains Napa's extraordinarily sweet, rich, concentrated fruit. This profound 1995 still tastes like an adolescent. It will benefit from another four to five years of bottle age, and should last easily for another 20 to 25 years. \$150

Visit [www.eRobertParker.com](http://www.eRobertParker.com) for the Internet's most active wine bulletin board, tens of thousands of tasting notes, or to order his recent book, *The World's Greatest Wine Estates: A Modern Perspective*. You can also subscribe to Parker's newsletter, *The Wine Advocate*. Request a sample copy at: *The Wine Advocate*, P.O. Box 311, Monkton, MD 21111.



# You Will, Won't You?

It's flattering to be asked, but being executor of an estate is time-consuming—and risky. **BY ANNE TERGESEN**

**F**or years, Ellen McLaughlin helped her elderly mother make investment decisions, pay bills, and prepare tax returns. Since her mother died in February, McLaughlin is still doing all that—and more. As executor of her mother's estate, McLaughlin has worked with attorneys, realtors, insurers, appraisers, and accountants to sell a house, value a stake in a privately held company, transfer assets, and, of course, prepare tax returns. Even though her mom had simplified matters by transferring assets to a trust, McLaughlin, a financial planner in Apollo Beach,

Fla., devotes more than 15 hours a week to her job as executor. "Even with my training, I've found it a challenge," she says.

McLaughlin is dealing with a well-organized estate and cooperative family members. If an estate is a mess and the heirs are at war with each other, acting as executor can be the job from hell. Just ask Joseph Butler, an FAA safety inspector from Somers, Conn., and co-executor of

his grandmother's estate. Four years ago he discovered that his grandmother's will and several valuable antiques were missing from the Worcester (Mass.) home she had bequeathed to the entire family. Since then, the estate has been tied up in legal battles, including one in which Butler hired a handwriting expert to debunk a will a cousin produced that named the cousin's mother sole heir. "It's been a real

headache," says Butler. The home will soon be sold, he says, and the proceeds divided according to state law, which governs estates with wills. Twenty-seven grandchildren share the money, Butler adds, with cousin's share docked for various expenses.

If asked to be an executor, you may be flattered, or loath to turn down a request. But think carefully before accepting. Executors are entitled by law to be paid, but the work is generally tedious and time-consuming, even if you farm it out to professionals. Moreover, you may make mistakes, you may damage relationships with other heirs or even be personally liable.

An executor's duties often begin with paying the funeral bills and end with making sure bequests have been distributed. Basic responsibilities include maintaining the estate's property. That means making sure valuables are safe, the lawn is mowed, the utility bills are paid, as well as dealing with any lingering legal matters.

Executors-in-waiting can head off problems by talking about the estate



## PLAYBOOK: BEST-PRACTICE IDEAS

### The Excellent Executor

#### If someone asks you to be an executor, you should:

- Get access to financial statements, insurance policies, and deeds.
- Find a professional who can help run the estate or break ties when co-executors disagree.
- Ask the estate owner to let heirs know what their inheritances will be.

#### Once you're acting as executor, be sure to:

- Record how you spend your time and the reasons for your decisions.
- Keep beneficiaries abreast of major decisions, such as the disposition of a concentrated block of stock.
- Consider taking an executor's fee. It can be a tax-savvy strategy.





## Executors can be held personally liable for mistakes

That's critical because executors found by a court to have mismanaged an estate—by, say, selling assets at fire-sale prices or turning a blind eye to unsuitable investments—

can face steep penalties, says

Nancy Levin, a partner at Evans, Latham & Campisi, a San Francisco law firm that specializes in trust and probate litigation.

It's also important to find out how the property is to be divided. One way to handle potential disputes: Ask mom or dad to break the news. Disappointed heirs may be less likely to lash out if notified before the estate owner's death about an inheritance than they would be in the emotional aftermath. "The easiest way to alleviate conflict is to keep everyone informed," says Susan Porter, managing director at U.S. Trust. M. Shannon Lunsford of Louisville, Colo., recalls that although his sister was upset when she learned she was written out of their stepfather's will, the fact that she had received advance notice helped keep the peace. "She was still hurt, but we were able to smooth things over a bit."

Most wills leave executors to divide the majority of personal items. As a result, executors may also have to referee disputes. Arguments over a watch or a ring "are often really over who mommy loved best,"

says William Forsyth, senior fiduciary counsel at Bessemer Trust, who once mediated a fight over a copy of an etching worth just \$15. "Only the threat of going to court persuaded the parties to relent," he says. If you anticipate bickering over possessions, ask the donor to specify who should get what—either in the will, where the instructions are binding, or in a letter, advises Joanne Johnson, managing director at JPMorgan Private Bank.

Since executors can be held personally liable, it's also important to protect yourself. For instance, if an investment portfolio is concentrated in a single stock, you may want to limit risk by diversifying, says Douglas Moore, head of estate and charitable planning for Citigroup Private Bank. Sometimes heirs prefer to keep these large holdings exactly as their parents did. To be prudent, try to obtain the approval of all the interested parties, says attorney Levin.

Fees can also be a source of conflict. Unless a will states otherwise, the executor is entitled to payment. Fees vary by state, and they can add up: In New York, they are 5% on the first \$100,000 of the estate, 4% on the next \$200,000, 3% on the next \$700,000, 2.5% on the next \$4 million, and 2% on the rest. On a \$10 million estate, that comes to \$234,000.

Since fees reduce the size of an estate, other heirs may resent you for taking one. Still, if estate tax is due, the family will save on taxes by paying an heir an executor's fee, says Witman. Why? While the executor will owe personal income tax on the fees, the highest federal rate is 35%. But if the money remains in the estate, the estate tax will claim 46%. You can always agree to compensate other heirs: Just be sure not to give each more than \$12,000 a year or you'll trigger a gift tax, says M. Holly Isdale, head of Lehman Brothers Wealth Advisory group.

Once in the job, keep a precise accounting of the estate's affairs and a record of the time you spend, as well as the reasons for your decisions. Mom or dad may have trusted your judgment, but there could be a disgruntled relative who doesn't. ■

**BusinessWeek** **online** For a podcast on being an executor, go to [businessweek.com/extras](http://businessweek.com/extras)

**BusinessWeek Weekend** For more on estates, watch *BusinessWeek Weekend*. Check your local listings or go to [businessweekweekend.com](http://businessweekweekend.com)



the owner while the per-  
s still alive. If you think the job might  
o much to handle, ask the estate own-  
r recommend professionals you can  
If there's a co-executor with whom  
on't always get along, request that an  
ative third party, such as the family ac-  
tant, be appointed to serve as a  
eaker, says Leonard Witman, partner  
Witman Stadtmauer & Michaels in  
am Park, N.J.

### KEEPING THE PEACE

C, SIT DOWN with the estate owner  
draw up an inventory of all debts and  
s. Make sure you know where all im-  
portant documents are stored—from bank  
brokerage statements to insurance  
policies and deeds. Being organized will  
help you meet key deadlines. For example,  
if estate taxes are due nine months af-  
ter death, you may need to be able to  
quickly identify which assets to sell to raise  
cash. And the better prepared you are, the  
less likely you'll be to make mistakes.



EDITED BY MONICA GAGNIER

## RETIREMENT

### NEW LAW, NEW BREAKS FOR IRA HOLDERS

**THE NEW PENSION PROTECTION ACT** largely addresses corporate plans, but it contains some goodies for individuals.

If you inherit a 401(k), you will be able to roll it over into an Individual Retirement Account and stretch out withdrawals—and the taxes on them—over the rest of your life. Before, only spouses could do that. Depending on the deceased's company, other heirs had to take the money as a lump sum, often within five years, and get hit with taxes right away.

Be sure to open a separate "inherited IRA" to receive the funds with a title that indicates who left you the money, says Natalie Choate, a lawyer with Bingham McCutchen in Boston.

(Example: John Doe, deceased IRA, payable to Junior

Doe as Beneficiary.")  
Next, arrange for a direct transfer of funds from the 401(k) into the IRA.

Another plus from the pension law: Donations of up to \$100,000 made directly from an IRA to a charity can now count toward the required minimum distribution for IRA owners 70½ or older. Depending on your bracket, the tax savings could be substantial. Act quickly: The deal is only good for 2006 and 2007.

On the downside, the new law bans taking deductions for donations of clothing or household goods unless the item is "in good used condition or better." Forget about write-offs for those ratty T-shirts.

—Deborah L. Jacobs and Ellen Hoffman



## INSURANCE

### A Log of Your Stuff

**IF YOU LOST POSSESSIONS** to a hurricane, flood, fire, or even a burglary, would you be able to back up your insurance claim? If not, consider using one of a dozen or more home inventory software programs to create a list and photos of your belongings, their cost, and other data. Where the programs differ is in the amount of detail on each item and the form of the records you can create.

The Quick'n Home Inventory Manager from Intuit and the Home Manager from kzssoftware.com, each \$29.99, offer user-friendly formats for recording basic information such as an item's name, cost, and where you bought it. If you want to cross-reference and create multicolored, multifont graphics such as pie charts and bar graphs, check out My Stuff Deluxe from Contact Plus (\$39.99 by download, \$49.99 as a CD-ROM). Truth be told, the free Home Inventory software you can download from the Insurance Information Institute's site ([www.knowyourstuff.com](http://www.knowyourstuff.com)) will suit most homeowners' needs.

—Ellen Hoffman

## STOCK MARKET

### HAPPY DAYS AGAIN?

**THE PAST FIVE YEARS** have not been great for stocks. The Standard & Poor's 500-stock index returned an annual average of 4.09%, including reinvested dividends (through Aug. 18). But affluent investors surveyed by JPMorgan Asset Management are looking for better times ahead. They expect average rates of return ranging from 10.4% (those age 40-44) to 14% (age 60-64) over the next five years. While the 14% annualized returns are a throwback to the boom years, 10.4% is not unreasonable at all. In fact, it's the long-term average.

Average annual rate of return expected from retirement assets over the next five years

| AGE   | RETURN |
|-------|--------|
| 40-44 | 10.4   |
| 45-49 | 11.5   |
| 50-54 | 11.7   |
| 55-59 | 10.8   |
| 60-64 | 14.0   |
| 65+   | 12.7   |

Data: JPMorgan Asset Management



Nickelodeon

# BARNYARD

Only In Theaters



**Aaron Parry**  
Executive Producer  
Paramount Pictures

**Julia Pistor**  
Executive Producer  
Nickelodeon Movies

**Mike Braico**  
Account Executive  
Sun

**Steve Oedekerk**  
Writer/Director/  
Producer  
Omaton

**Anthony Lopez**  
Lead Systems  
Administrator  
Omaton

**Otis**  
Movie Star

Share the creative process. Paramount Pictures, Nickelodeon Movies and Omaton Animation Studios brought top industry talent together for the production of their animated film *Barnyard*. As the artists began the intensive process of 3D rendering, they realized that their infrastructure could use a helping hand. Enter the powerful x64 servers from Sun. With the time and resources they saved, the rendering of the movie was completed in 6 months—warp speed in the animated-film business. The results are extraordinary. The power is the collaboration. The network is the computer.™ Share.

[sun.com/x64](http://sun.com/x64)



share





BY GENE G. MARCIAL

**WAS THE RECENT SELL-OFF AT LAS VEGAS SANDS "UNJUSTIFIED?"**

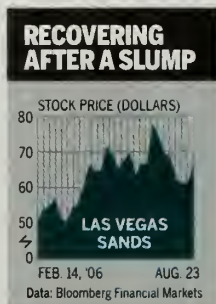
**PUT BRINK'S ON THE BLOCK, SAY THE BIGGEST STAKEHOLDERS.**

**ANALYSTS FORESEE ROBUST GAINS FOR BIOTECH SUPERGEN.**

## Sands: Still Hot in Macao

**G**O-GO CASINO OPERATOR Las Vegas Sands (LVS) saw its stock plummet in July from 77 to 60 when investors began to worry that its dominance in Macao was under threat. They panicked because Wynn Resorts will open operations there on Sept. 6. After the sell-off, the stock rebounded to 65.69 by Aug. 23. "The drop was unjustified," says Charles Norton of GNI Capital, which owns shares. "We aim to be long-term investors because Sands will remain No.1 in Asia." He thinks Wynn will need two years to catch up in Macao, the only place in China where casinos are currently legal, and where gamblers spent \$5.6 billion in 2005. By then, says Norton, Sands will have opened a second Macao casino—as

well as the first casino in Singapore. In Las Vegas, where its Venetian is drawing high-rollers in droves, Sands will open the Palazzo in 2007. Analysts say it will be the largest convention resort in the world. Rod Petrik of Stifel Nicolaus, which has done business with Sands, rates it a "buy" and figures the stock is worth 80 on a sum-of-the-parts basis, excluding the Singapore unit, a yet-to-be-approved project in Hengqin in China, or a proposed casino in Pennsylvania. Petrik forecasts 2006 earnings of \$1.46 a share on sales of \$2.1 billion, rising to \$2 in 2007 on \$3.4 billion, vs. \$1.17 on \$1.7 billion last year.



## Unlocking the Treasure In Brink's

**I**S SECURITY KING BRINK'S (BCO) on the verge of being sold? Its stock rose from 48 in February to 55.25 on Aug. 23, spurred by demands from activists that it be put up for sale. Pirate Capital, the largest shareholder, with an 8.7% stake, said in an Aug. 9 letter to the board that the stock didn't reflect the full value of Brink's businesses or their "stable cash flow." CEO Michael Dan replied that the board will "seriously discuss" the matter. A spokesman declined to say when. Three other large stockholders, MCM Management, Steel Partners, and Fidelity Investments, who together control a further 23.9%, agree. "There's no doubt Brink's is undervalued," says Clay Lifflander, president of MCM, which owns 8.2%. While Pirate values Brink's at 68 to 72, Lifflander says it's worth 80, based on projected 2007 earnings before

interest, taxes, depreciation, and amortization (EBITDA). He doesn't expect the board to "sit on its hands and let Brink's languish." He thinks private equity funds would be attracted to its cash flow. Michael Hoffman, managing director at Friedman Billings Ramsey Group, rates Brink's, with a market cap of \$3 billion, as "outperform." Strategic buyers, he says, could include General Electric and United Technologies. Both refused to comment on market speculation.

**ON THE UP AND UP**



## A Super Outlook For SuperGen

**B**IOTECHS HAVE NOT fared well in this fickle market. SuperGen (SUPG), a small outfit focused on therapeutic solid tumors, hematological malignancies, and other blood disorders, has slumped from 5.69 in March to 3.31 in Aug. 23. Yet some pros remain bullish. Elemer Piro of Rodman & Renshaw sees it at 24 in 12 months. Vinny Jin of ThinkEquity Partners has a more modest target of 8. Behind their optimism: SuperGen's Food & Drug Administration-approved Dacogen drug for myelodysplastic syndrome, sold in the U.S. by MGI Pharma. Jindal figures Dacogen sales will be \$25 million this year, rising to \$250 million in 2010, driving royalties from \$6 million to SuperGen to \$87 million in 2010. Piro forecasts higher sales, hitting \$197 million in 2007 and \$673 million in 2011. But before then, he expects MGI will buy SuperGen to avoid shelling out more royalties.

SuperGen has already received \$20 million from MGI and is sitting on a \$50 million pile of cash in the second quarter. Piro expects SuperGen to be cash-flow positive from 2007 third quarter. Despite the gap between the analysts' forecasts, they agree on one thing: The stock will be higher in a year.

**LOWER OF LATE**



**BusinessWeek online** Gene Marcial's Inside Wall Street is posted at [businessweek.com/investor](http://businessweek.com/investor) at 5 p.m. EST on the magazine's publication day, usually Thursdays.

**Note:** Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.



*Secretly, Dave suspected that only one of the consultants would really fit in with his team.*

### Need deeper understanding?

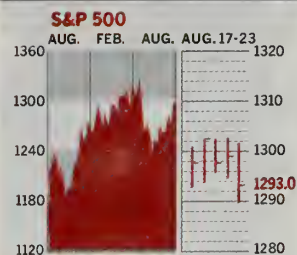
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## STOCKS



### COMMENTARY

Will falling housing markets take down the stock market? The indexes were doing fine until Aug. 23 when sales of existing homes came up short of forecasts and left investors timorous. S&P 500 Homebuilders fell 2.8% in a day, as did Home Depot and Lowe's. The S&P lost 0.2% for the week. Worries mount that consumer spending will go the way of house prices.

Data: Bloomberg Financial Markets, Reuters

## U.S. MARKETS

|                       | AUG. 23  | WEEK | % CHANGE YEAR TO DATE | % CHANGE LAST 12 MONTHS |
|-----------------------|----------|------|-----------------------|-------------------------|
| S&P 500               | 1293.0   | -0.2 | 3.6                   | 6.2                     |
| Dow Jones Industrials | 11,297.9 | -0.3 | 5.4                   | 7.4                     |
| NASDAQ Composite      | 2134.7   | -0.7 | -3.2                  | -0.1                    |
| S&P MidCap 400        | 737.8    | -1.5 | 0.0                   | 4.9                     |
| S&P SmallCap 600      | 360.9    | -1.8 | 2.9                   | 5.6                     |
| DJ Wilshire 5000      | 12,902.6 | -0.4 | 3.2                   | 6.3                     |

## SECTORS

|                      | AUG. 23 | WEEK | % CHANGE YEAR TO DATE | % CHANGE LAST 12 MONTHS |
|----------------------|---------|------|-----------------------|-------------------------|
| BusinessWeek 50*     | 730.9   | -0.4 | -1.5                  | 1.5                     |
| BW Info Tech 100**   | 381.4   | -0.9 | 0.3                   | 4.8                     |
| S&P/Citigroup Growth | 598.4   | -0.1 | 0.3                   | 2.7                     |
| S&P/Citigroup Value  | 692.8   | -0.3 | 7.0                   | 9.9                     |
| S&P Energy           | 435.1   | 1.0  | 16.7                  | 18.8                    |
| S&P Financials       | 446.9   | -0.1 | 4.8                   | 12.4                    |
| S&P REIT             | 176.8   | 0.8  | 15.5                  | 17.6                    |
| S&P Transportation   | 242.7   | -3.6 | -2.8                  | 11.6                    |
| S&P Utilities        | 172.9   | 0.6  | 8.3                   | 6.7                     |
| GSTI Internet        | 167.3   | 0.2  | -18.5                 | -2.9                    |
| PSE Technology       | 787.6   | -1.1 | -5.8                  | -1.3                    |

\*Mar. 19, 1999=1000 \*\*Feb. 7, 2000=1000

## GLOBAL MARKETS

|                             | AUG. 23  | WEEK | % CHANGE YEAR TO DATE | % CHANGE LAST 12 MONTHS |
|-----------------------------|----------|------|-----------------------|-------------------------|
| S&P Euro Plus (U.S. Dollar) | 1733.8   | -1.0 | 14.7                  |                         |
| London (FT-SE 100)          | 5860.0   | -0.6 | 4.3                   |                         |
| Paris (CAC 40)              | 5082.7   | -1.1 | 7.8                   |                         |
| Frankfurt (DAX)             | 5775.5   | -0.6 | 6.8                   |                         |
| Tokyo (NIKKEI 225)          | 16,163.0 | 0.6  | 0.3                   |                         |
| Hong Kong (Hang Seng)       | 17,088.4 | -2.1 | 14.9                  |                         |
| Toronto (S&P/TSX Composite) | 12,195.1 | 1.4  | 8.2                   |                         |
| Mexico City (IPC)           | 20,742.4 | -0.8 | 16.5                  |                         |

## FUNDAMENTALS

|                                      | AUG. 22 | WEEK AGO | YE |
|--------------------------------------|---------|----------|----|
| S&P 500 Dividend Yield               | 1.84%   | 1.87%    | 2. |
| S&P 500 P/E Ratio (Trailing 12 mos.) | 171     | 170      | 1  |
| S&P 500 P/E Ratio (Next 12 mos.)*    | 14.2    | 13.9     | 1  |
| First Call Earnings Revision*        | -0.95%  | -0.66%   | 0  |

\*First Ca

## TECHNICAL INDICATORS

|                                       | AUG. 22 | WEEK AGO | PO |
|---------------------------------------|---------|----------|----|
| S&P 500 200-day average               | 1274.2  | 1272.0   | PO |
| Stocks above 200-day average          | 53.0%   | 52.0%    | Ne |
| Options: Put/call ratio               | 0.86    | 0.88     | PO |
| Insiders: Vickers NYSE Sell/buy ratio | 2.99    | 2.73     | Ne |

## BEST-PERFORMING GROUPS

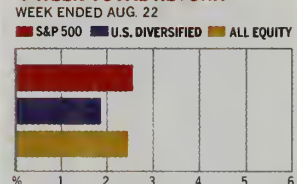
|                          | LAST MONTH % |                          | LAST 12 MONTHS % |
|--------------------------|--------------|--------------------------|------------------|
| Tires & Rubber           | 19.2         | Agricultural Products    | 86.6             |
| Fertilizers & Ag. Chems. | 15.1         | Steel                    | 77.7             |
| Divsfd. Metals & Mining  | 14.2         | Divsfd. Metals & Mining  | 66.7             |
| Compr. Stge. & Perphs.   | 14.1         | Fertilizers & Ag. Chems. | 48.9             |
| Constr. Materials        | 13.3         | Constr. & Engineering    | 47.4             |

## WORST-PERFORMING GROUPS

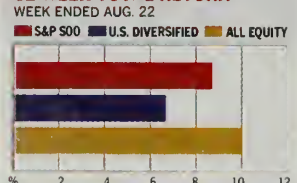
|                        | LAST MONTH % |                      | LAST 12 MONTHS % |
|------------------------|--------------|----------------------|------------------|
| Internet Retailers     | -15.2        | Educational Services |                  |
| Air Freight & Couriers | -9.9         | Homebuilding         |                  |
| Wireless Services      | -9.5         | Internet Retailers   |                  |
| Personal Products      | -7.9         | Tires & Rubber       |                  |
| Auto Parts & Equip.    | -7.3         | Wireless Services    |                  |

## MUTUAL FUNDS

### 4-WEEK TOTAL RETURN



### 52-WEEK TOTAL RETURN



Data: Standard & Poor's

## EQUITY FUND CATEGORIES

| 4-WEEK TOTAL RETURN      | %   | 52-WEEK TOTAL RETURN     | %    |
|--------------------------|-----|--------------------------|------|
| <b>LEADERS</b>           |     | <b>LEADERS</b>           |      |
| Japan                    | 6.8 | Precious Metals          | 69.0 |
| Precious Metals          | 6.1 | Latin America            | 49.2 |
| Technology               | 5.6 | Diversified Emrg. Mkts.  | 30.6 |
| Diversified Pacific/Asia | 5.6 | Diversified Pacific/Asia | 25.2 |
| <b>LAGGARDS</b>          |     | <b>LAGGARDS</b>          |      |
| Miscellaneous            | 0.7 | Technology               | 2.4  |
| Health                   | 0.9 | Health                   | 3.2  |
| Small-cap Growth         | 1.0 | Large-cap Growth         | 3.5  |
| Small-cap Blend          | 1.2 | Small-cap Growth         | 4.5  |

## EQUITY FUNDS

| 4-WEEK TOTAL RETURN        | %     | 52-WEEK TOTAL RETURN       | %     |
|----------------------------|-------|----------------------------|-------|
| <b>LEADERS</b>             |       | <b>LEADERS</b>             |       |
| DireXn. Jap. Bull 2X Inv.  | 13.7  | U.S. Global Invsr. Gold    | 100.8 |
| ProFunds. Ult. Japan Inv.  | 13.6  | Midas                      | 99.0  |
| Matthews India             | 12.9  | U.S. Gbl. Invs. Prc. Mnl.  | 91.3  |
| ProFunds. Semicdr. Inv.    | 12.2  | Van Eck Invsr. Gold A.     | 85.5  |
| <b>LAGGARDS</b>            |       | <b>LAGGARDS</b>            |       |
| Ameritor Investment        | -33.3 | Ameritor Investment        | -81.8 |
| American Heritage Grth.    | -25.0 | American Heritage Grth.    | -50.0 |
| ProFds. Mble. Tlcmms. Inv. | -17.1 | ProFds. Mble. Tlcmms. Inv. | -24.9 |
| ProFunds UltSh. Jap. Inv.  | -12.6 | American Heritage          | -22.2 |

## INTEREST RATES

### KEY RATES

|                          | AUG. 23 | WEEK AGO | YI |
|--------------------------|---------|----------|----|
| Money Market Funds       | 4.84%   | 4.84%    |    |
| 90-Day Treasury Bills    | 5.10    | 5.07     |    |
| 2-Year Treasury Notes    | 4.87    | 4.88     |    |
| 10-Year Treasury Notes   | 4.81    | 4.86     |    |
| 30-Year Treasury Bonds   | 4.95    | 4.99     |    |
| 30-Year Fixed Mortgage † | 6.25    | 6.32     |    |

†BancQue

## BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

|                       | 10-YR. BOND | 30-YR |
|-----------------------|-------------|-------|
| General Obligations   | 3.93%       |       |
| Taxable Equivalent    | 5.61        |       |
| Insured Revenue Bonds | 4.05        |       |
| Taxable Equivalent    | 5.79        |       |

## THE WEEK AHEAD

### CONSUMER CONFIDENCE

Tuesday, Aug. 29, 10 a.m., EDT »The Conference Board's August consumer confidence index is forecast to have eased from 106.5 to 103.5. That's the median forecast of economists surveyed by Action Economics.

### GROSS DOMESTIC PRODUCT

(REVISED) Wednesday, Aug. 30, 8:30 a.m., EDT »A second look at second-quarter real GDP will probably show annualized

growth of 2.9%, up from the original 2.5% rate.

PERSONAL INCOME Thursday, Aug. 31, 8:30 a.m. EDT »July personal income most likely rose 0.4%, after a 0.6% jump in June. Consumer spending probably increased 0.6% in July after rising 0.4% in the prior period.

EMPLOYMENT Friday, Sept. 1, 8:30 a.m. EDT »Nonfarm payrolls are forecast to have risen by 125,000 workers in August,

after a gain of just 113,000 jobs in July. The jobless rate probably edged down to 4.7%.

### PURCHASING MANAGERS' INDEX

Friday, Sept. 1, 10 a.m. EDT »The Institute for Supply Management's July factory activity index very likely slipped to 54.4%.

### CONSTRUCTION SPENDING

Friday, Sept. 1, 10 a.m. EDT »Building outlays in July probably held steady after posting a gain of 0.3% in June.

The BusinessWeek production slipped to 284.1 for the week Aug. 12 but stood 13.2% above year-ago value. Before calculating the four-week moving average, index fell to 284.2.

## BusinessWeek

For the BW50, more investor data, and the components of the production index visit [www.businessweek.com/extras](http://www.businessweek.com/extras)

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IT Management

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# Getting to 'Aha!'

**INNOVATION** The Five Disciplines for Creating What Customers Want  
By Curtis R. Carlson and William W. Wilmot; Crown Business; 368pp; \$27.50

How is it that some inventors like Thomas Edison are able to crank out one breakthrough after another, while others can spend a lifetime searching in vain for a single great idea? Similarly, why do some companies like Apple prove themselves capable of constantly churning out hit product after

hit product, while other once-hot enterprises like Polaroid wither or die?

These questions have long vexed scientists, business executives, and management gurus alike. In their new book, *Innovation: The Five Disciplines for Creating What Customers Want*, co-authors Curtis R. Carlson and William W. Wilmot argue that true innovation isn't, as Hollywood has it, the result of a "Eureka!" moment in a forlorn lab.

Instead, they contend it more often springs from a disciplined approach to identifying and then delivering new products or services that fill a societal need. Indeed, Carlson, chief executive of SRI International, a contract research and development firm in Menlo Park, Calif., believes that the more methodical and systematic companies are in their approach to innovation, the greater their chances at success. That gives hope to those of us who aren't named Da Vinci or Jobs, and makes this book a worthwhile read for any executive trying to keep his or her company ahead of the competition.

Carlson practices what he preaches. When he became CEO of the storied research shop in the 1990s (SRI had gained renown as far back as the 1970s for inventing everything from the computer mouse to robotic surgery), the firm's revenues were stagnant and its innovation pipeline had dried up. Carlson analyzed the situation and realized that the firm's approach to R&D was scattershot, and there was no framework for identifying and championing promising ideas.

But over the next decade, Carlson returned SRI to double-digit growth by instituting the "five disciplines" that he and Wilmot dissect in workbook fashion: identifying important customer needs, creating solutions that fill those needs, building innovation teams, empowering "innovation champions" who keep the effort on track, and, finally, aligning the entire enterprise around creating value for customers. To that end, Carlson and Wilmot suggest spending a lot of face time with customers to get real-time feedback on your ideas from the outset. "Get out of your office, hit the road. The best source of information about

whether your value proposition is on the right track is your prospective customers and partners," they write.

Contrary to what most executives might believe, the authors argue that building an innovative company doesn't require a cultural overhaul. "You do not have to totally change your enterprise, fire all your people, or import arcane practices that no one understands," they advise. Among the alternatives they offer: the "Watering Hole," a brainstorming session where new ideas undergo a formal review process. Carlson runs this forum every two to six weeks at SRI, with five to 20 participants from different departments, including

the team pitching an idea, technical and legal staff, and a market expert, as well as current or potential business partners.

Presenters make a five- to 20-minute presentation, followed by 10 to 30 minutes of feedback around four key questions: What is the market need? What is your approach to addressing this need? What are the benefits vs. costs of your approach? How do these benefits compare with the competition's? Carlson and Wilmot, who helped create the innovation workshop runs for outside companies, say their experience at SRI has proven this format spurs critical collaboration among once-siloed departments.

"Watering holes are an excellent way to eliminate organizational boundaries, which are major barriers to innovation in most companies," they write.

Still, the authors caution against even the best procedures as a shortcut to perseverance. They recount how when a colleague told Thomas Edison that he had again failed to find a filament that would not burn out, Edison replied, "I didn't fail. I just found something else that doesn't work." And sometimes the ultimate market for a great idea isn't the one you first imagine.

Carlson and Wilmot note that when one SRI engineer developed a technique for printing metals on paper—thinking it could revolutionize the greeting-card business—the idea was scrapped after the realization that the potential market was small, and there were already cheaper alternatives. But further research showed that a better application for the technology was printing cheap antennas for Radio Frequency Identification Device tags. In the pursuit of innovation, there doesn't always have to be a Eureka moment. ■

—By Dean



**Genius is still 99% perspiration, but there are systematic ways to sweat**

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## How Oil Fuels Sino-U.S. Fires

The emergence of China over the past decade as a major importer of oil has catapulted energy toward the top of the list of issues—up there with trade and Taiwan—that are major sources of friction in Sino-American relations. China's rapidly rising demand for energy is stoking anxiety in Washington that there is not enough oil in the world to satisfy the appetites both of

America's 300 million gas-guzzling citizens and of 1.3 billion Chinese. In turn, America's unease has raised concerns in Beijing that the U.S. might deny China access to the oil it needs for continued economic growth.

Much has been made over this looming fight. Yet the real conflict brewing between the two powers isn't because of direct competition for physical barrels of crude, but rather because oil is inextricably linked to other foreign policy issues on which Beijing and Washington don't see eye to eye.

Oil's increasing role in China's foreign policy reflects a surging demand. China is second only to the U.S. in world consumption, and it's No. 3 in imports, following the U.S. and Japan. Its demand has more than doubled in the past decade. China consumes 7 million barrels a day, one-third the U.S. level, and it imports 3.3 million bbl. a day, one-quarter the U.S. level. But the International Energy Agency projects Chinese demand in 2011 will be 9.1 million bbl. a day, with imports of 5.3 million bbl.

**CHINA'S GROWING DOMESTIC** oil deficit has prompted it to follow in the footsteps of other major importers to ensure access to oil. China is diversifying its suppliers, encouraging its national oil companies to acquire assets abroad, and cultivating closer diplomatic relations with exporting nations. Although these are moves long employed by other countries, their adoption by China has sounded alarm bells in Washington. (Remember the furor over CNOOC's ill-fated bid for Unocal last year?)

The two most prominent spots where China's search for oil collides with American interests are the Sudan (the largest source of foreign production for Chinese companies) and Iran (China's No. 3 supplier of crude imports). While Washington sees a major power using its permanent seat on the U.N. Security Council to frustrate efforts to halt genocide in Darfur and to slow international action to curb Iran's nuclear ambitions, Beijing sees international policies of limited efficacy that might jeopardize its oil supply.

**Oil is inextricably linked to other policy issues that divide the two powers**

So far, China has weighed its oil interests against the interests of the international community on a case-by-case basis. In the case of Sudan, the scales have tipped in favor of oil. Beijing weakened the language of at least one Security Council resolution to punish the Sudanese government for the atrocities in Darfur, but recently agreed to the deployment of U.N. forces there if supported by the African Union. In the case of Iran, which requires balancing competing interests such as oil, regional stability, and the Sino-American relationship, Beijing has sided with the international community to date. China voted as a member of the board of governors of the International Atomic Energy Agency in

February, under pressure from Washington, to report the Iran nuclear issue to the U.N. and supported the July 31 Security Council resolution threatening sanctions if Iran does not halt uranium enrichment. However, deeper energy ties to Iran (the No. 2 holder of global oil and reserves) might tempt Beijing to tip the scales the other direction.

Indeed, the risk for Washington is that China's growing dependence on imported oil will increasingly prompt Beijing to give high priority to oil than to international issues such as the protection of human rights, nuclear nonproliferation, and good governance. So the challenge for America is to persuade Beijing to satisfy its oil demand in ways that do not

support states whose behavior violates international norms. This is easier said than done. Oil plays an ever more prominent role in China's diplomacy. And Beijing's assessment of what constitutes bad behavior by other states and how it should be dealt with often differs from Washington's. The best bet for the U.S. is to encourage China to act like the responsible emerging power it claims to be. Time may be on Washington's side. As China's global influence continues to grow, the international community will expect China to back up its words with actions. ■

*Erica S. Downs, a former analyst for the CIA, is China Energy Fellow in the China Initiative at the Brookings Institution.*

Views expressed in Outside Shot are solely those of contributors.



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# Ideas **The Welch Way**

BY JACK AND SUZY WELCH

## When to Go with Your Gut

**What would you do if your employees had a tendency to rely more on gut instinct than on facts and rational thinking? Mine do. How can I explain their decisions to company executives?**

—Kike Tri Wicaksono, Jakarta

You really have two choices. Either tell your bosses: “Charlie made that terrific decision based on his tried-and-true gut instinct.” Or if Charlie’s gut is 50-50 at best, ask him to stop making decisions that way.

As a general rule, though, gut instinct is nothing to be ashamed of. Quite the opposite. It’s really just pattern recognition, isn’t it? You’ve seen something so many times over your life or career that you just get what’s going on without a lot of deep thinking. Gut instinct is a deep, even subconscious, familiarity—the voice inside you that tells you “Go for it NOW” or “No way—not ever.” We would wager, however, that the most common gut call falls in between the two. We’re talking about the “uh-oh” response in which your stomach informs you that something is not right.

The trick, of course, is to know when to go with your gut. That’s easy when you discover, over time, that your gut is usually right. But such confidence can take years.

Until that point, we suggest a rule of thumb: Gut calls are usually pretty helpful when it comes to looking at deals and less so when it comes to picking people.

No, we’re not mixing them up. Even though proposals arrive with all sorts of data analysis and detailed quantitative predictions, and people decisions seem so much more qualitative, the numbers in deal books are really just projections. Sometimes those projections are reasonable; other times they represent little more than hopes and prayers. When have you ever been presented with a deal with a projected discounted rate of return of less than 20%? You haven’t! So when it comes to looking at deals, consider the numbers. But be sure your gut plays a big role in the final call.

Say you’ve been asked to invest in a new office building. You visit the city and see cranes in every direction. The deal’s numbers are perfect, you’re told; you can’t lose. But your gut tells you otherwise. Overcapacity is about a year away, and the “perfect” investment is about to be worth 60¢ on the dollar. You’ve got few facts, but you have that uh-oh response. More

often than not, that means you should kill the deal even if it infuriates the so-called rational thinkers on the case. Oddly, they’ll give you credit for prophetic thinking down the road (although probably with less public gusto than you’d like).

By contrast, relying on your gut during hiring isn’t always a great idea. The reason: Our gut often makes us “fall in love” with a candidate too quickly. We see prestigious schools, great experience on a sparkling résumé. We see a likable candidate who says all the right things in the interview. And even though we don’t admit it, too often we see a person who can quickly make a problem go away—namely, a gaping hole in a position we need to fill fast. So we rush to seal the deal.

We run into this dynamic in action all the time when people call us for references. They start off by firmly stating that they only want an unvarnished view of the candidate in question. But as we begin to give them the straight story, we can hear their voices tighten. It’s almost as if they’re saying: “Oh, I don’t tell me that. All I really wanted from you was a standard approval.” They can’t get off the phone fast enough.

So when it comes to hiring decisions, doubt and doubt-check your gut. Go beyond the résumé. Dig for extra data. And don’t just make reference calls; force yourself to listen especially to mixed messages and unpleasant insights.

Overall, however, your gut can play a real role in business decisions. Don’t worry too much about explaining that to your bosses and shareholders. They use theirs, too.

**I’m 58 and about two years ago took a forced “early retirement” from my middle management job in sales. Since then, I’ve had trouble getting back in the game. I’m not ready to call it quits. What next?**

—Anonymous, Kansas City

Having exhausted traditional companies that obviously value you too old, too unfamiliar with the ways of the new world, otherwise too problematic; you’ve got at least one option remaining: find a company where hiring you represents absolutely zero risk. You need a job where you get paid a commission and receive little or no salary. Yes, most of the positions will feel like nursery school to an old sales hand like you. But with your experience and ambition, you should be skipping grades pretty quickly. All you need is that first step, which we assure you will swing open when you say the words: “Give me a shot—I’m free.” ■

*Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at [thewelchway@businessweek.com](mailto:thewelchway@businessweek.com). For their weekly podcast, go to [businessweek.com/search/podcasting.htm](http://businessweek.com/search/podcasting.htm)*

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doing a deal,  
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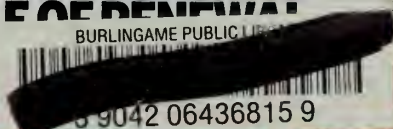
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6 September 11



# BusinessWeek

SEP 11, 2006 www.businessweek.com

## How Toxic Is Your Mortgage?

Deceptive loans.  
Phantom profits.  
And coming soon:  
A wave of defaults.

BY ANITA DER HOVANESIAN (P.70)

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# HUMAN

HUMAN

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**AND JUST LIKE THAT, THE LAWS OF CHEMISTRY CHANGE.** A world that includes

the Human Element, along with hydrogen, oxygen and the other elements, is a very different world



indeed. Suddenly, chemistry is put to work solving human problems. Bonds are formed

between aspirations and commitments. And the energy released from reactions fuels a



boundless spirit that will make the planet a safer, cleaner, more comfortable place for generations to

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More home owners will soon wake up to much higher mortgage payments, in addition to lower house values



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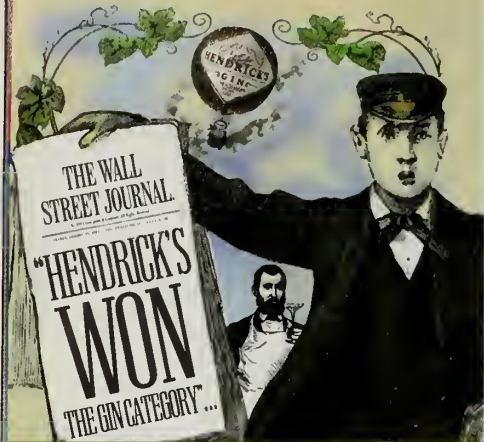
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## THE WALL STREET JOURNAL.

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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# What's Hot This Week At BusinessWeek.com

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## Asia's Best Entrepreneurs Under 25? You Decide

Until recently, large corporations have been the engines powering growth in Asia. Today, the continent is **a hotbed of startup activity**, where entrepreneurs turn smart ideas into thriving independent companies. With this in mind, BusinessWeek.com set out to find Asia's Best Entrepreneurs under the age of 25. Readers nominated more than 100 candidates and our editors narrowed the list down to **20 finalists**. Our slide show profiles them all. Read about their scrappy businesses and **vote on the most promising**—we'll announce five winners next month. Also, take a look at Korean startup Cor Logic, Asia's fastest-growing mobile multimedia chip company. Find out about **the new Samurai spirit** in Japan, where venture funds are luring the best and brightest to become a new class of startup warriors. And learn about a different enticement, microfinance, that's stoking **entrepreneurialism** in India, where large banks are lending small amounts to rural startups and reaping the rewards. For all this and more, go to: [www.businessweek.com/go/06under25](http://www.businessweek.com/go/06under25)

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## intellectual property, and why you don't have to think about it.

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**100** A CENTURY OF  
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"They've... thrown out the part that makes things look worse."

—Ethan S. Harris, Lehman Brothers' chief U.S. economist, criticizing the Fed's focus on core inflation, which, he says, downplays the impact of higher oil prices, as reported in The New York Times

EDITED BY DEBORAH STEAD

## OFFICE PARTIES O, UM, HOW BOUT LAST GHT'S GAME?

**ASK YOUR** company has  
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h of the cash used to  
d the company has come  
i Oak Investment Partners,  
nture capital firm whose  
aging partner, Ann  
ont, has close ties to the  
r camp. Lamont, who  
on athenahealth's board,  
arried to antiwar  
torial candidate Ned



Lamont, who beat Senator Joe Lieberman in Connecticut's Democratic primary on Aug. 8 in part by saying Lieberman was too cozy with the President.

How to handle it? Avoidance works, says CFO Carl Byers. "We're busy, so it doesn't come up that much." Lamont did give advance notice to athenahealth of her husband's candidacy. And it helps that Jon Bush isn't an especially active Republican. He has made only one campaign contribution in the last three elections, according to the Center for Responsive Politics. (Ann Lamont gave \$2,000 each to Howard Dean and John Kerry in 2003, according to [opensecrets.org](http://opensecrets.org).) He's "a loyal Republican, but he thinks the party should follow him," Byers jokes.

—Timothy J. Mullaney

READY FOR  
ALTERNATIVES  
Demonstrators  
in San Francisco



## GOLDEN STATE

# Sticking Oil with Ethanol's Bill

**WHILE TALK OF A WINDFALL** profits tax on Big Oil has fallen to a whisper in Washington, D.C., it's reaching high decibel levels in California, where voters will decide in November if the state should impose \$4 billion worth of new drilling fees. If the measure, Proposition 87, passes, the proceeds will finance solar, ethanol, and other alternative energy technologies. So far, independent polls show it passing by as much as 2 to 1, thanks largely to anger over high gas prices. "Make oil companies pay," declares one pro-tax local TV ad.

California producers Chevron, Exxon Mobil, Shell, and Occidental Petroleum are ponying up \$30 million for ads to defeat the proposal, which they say will discourage the state's already declining oil production. Prop 87 calls for a tax of up to 6% on oil produced in the state. One provision bans passing on the expense to consumers but doesn't spell out enforcement.

The initiative was dreamed up by Tony Rubenstein, a Los Angeles community activist. Big donations have come from his friend, film producer Stephen Bing, as well as from Silicon Valley venture capitalists John Doerr and Vinod Khosla, who have made alternative energy investments a major focus of their portfolios.

—Christopher Palmeri



## 2003 Hurricane Katrina

|                                         |      |
|-----------------------------------------|------|
| How way agencies interact with public   | 44%  |
| Provide individual financial assistance | 43%  |
| Prepare for future recurrences          | 29%* |
| Build infrastructure, help repair homes | 26%  |

\*Based on preparation mentioned more often by pre-hurricane residents of New Orleans  
Source: Harvard Medical School; Scientific Collaborators of the Hurricane Katrina Community Advisory Group



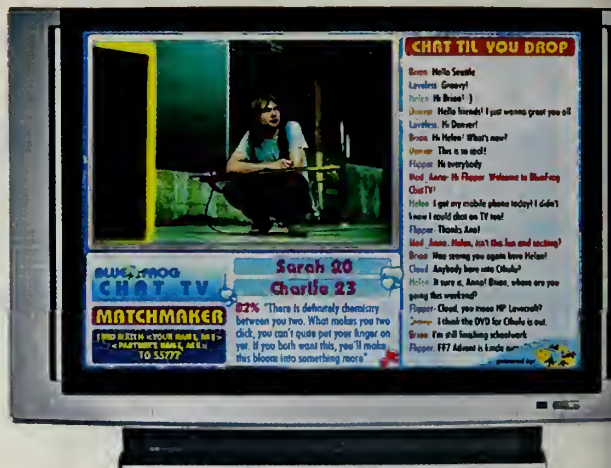
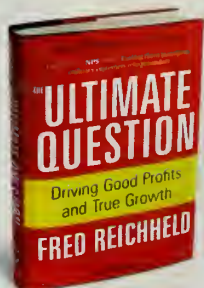
## A STRATEGY THAT ISN'T IN THE BOOK

One strategy it doesn't suggest, however, is launching a word-of-mouth campaign with a firm that has an army of ready-to-buzz folks equipped with free books, background material, and guides that include ideas for conversation starters. Yet when marketing his book, Reichheld did just that. As at least one rival in the customer satisfaction field has noted, 12 of the book's 40 reviews on [Amazon.com](http://Amazon.com) were written by self-identified members of **BzzAgent**, a Boston-based word-of-mouth marketing firm. Nearly all 12 were glowing. (BzzAgent doesn't pay its agents, nor urge them, it says, to give positive reviews. Agents get points that can be redeemed for prizes by reporting back on their "buzz" activities.)

Bain representatives initially said the book's publisher, **Harvard Business**

But the publisher wasn't the source. Reached later, Reichheld said he had accepted an offer from BzzAgent's founder and CEO, Dave Balter, for a free word-of-mouth campaign. (In return, Reichheld spoke to BzzAgent employees about his ideas.) Reichheld's view is that BzzAgent helped "legitimately energize" readers who would have

had interest in the book anyway. "I thought since I was working in this area of word-of-mouth it would almost be irresponsible of me not to take that experiment," he says. —*Jena McGregor*



## RUNNING COMMENTARY

**TRYING TO TAP** into the text-messaging craze, some TV stations are starting to publicize number codes for mobile users who want to shoot messages from their phones to the TV screen during certain shows. The messages, visible to all viewers, become part of the show (Seattle's Blue Frog Mobile, which provides the technology, has workers screen for obscenities). The service is big at music channels in Indianapolis, Phoenix, and Los Angeles. As stations lure back young viewers they've lost, mobile operators rack up messaging sales. With each message bringing in about 10¢ of revenue, says Julie Ask, an analyst for JupiterResearch, "the carriers love it." —Roger O. Crockett

## DRAWN & QUARTERED





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## TARTAN TIES



## A BONNIE BIT OF NETWORKING

Love golf, *Braveheart*, or anything else Scottish? Try to wangle an invitation to join **Globalscot**, the networking club launched in 2001 by Scotland's economic development agency. Among the nearly 1,000 members so far: Donald Trump (his mother was a Scot), Monsanto CEO Hugh Grant (Scottish born), and Indian biotech entrepreneur Kiran Mazumdar-Shaw (married a Scot). "You have to be Scottish or have an affinity for Scotland," explains Globalscot chief Mark Hallan. What's in it for members, who help Scottish enterprises by providing contacts and advice? Pride, perhaps, or a chance to yell, in the words of comedian Mike Myers, "if it's not Scottish, it's craaap!" On Sept. 27, Globalscot, which worked with the World Bank to help Chile and Mexico create similar networks, will have its first gathering in Edinburgh. Among those planning to attend: Disney's consumer products chief, Andrew Mooney, and Ian Crawford, IBM's vice-president for global procurement. Pass the single-malt. —Diane Brady

## THE MESSAGE

## SNEEZE AND YOU'LL MISS THESE ADS

**FIRST CAME** "adlets," five-second messages slipped into TV and radio shows to thwart ad zappers or those who tune away during commercials. Now, radio giant **Clear Channel Communications** is running "blinks," which last just two seconds—short enough to fit between tunes in a deejay-mixed nonstop music hour. On Aug. 21, about 15,000 blinks aired across the network's 1,100-plus channels to promote the season premiere of **Fox Broadcasting's** TV show, *Prison Break*. Soon, Clear Channel's 110 million listeners will catch others as they flit by: On Sept. 5, 15,000 blinks will promote the latest season of Fox's *House*. On Sept. 10, another 15,000 will air for *The Simpsons* (Homer's iconic "D'oh!" or "WOOHOO!" followed by "Tonight on Fox!").

Working with Fox's creative



» **THE BRAND** Fox Broadcasting » **THE CAMPAIGN** Two-second radio ads on Clear Channel's 1,100+ stations » **THE VERDICT** Works for loyal fans

people, Clear Channel first aimed for one-second ads. "We wanted something super succinct," says Jim Cook, senior vice-president of creative services. Fox's Eric Poole, vice-president of radio promotion, tried about 50 sound samples to advertise six Fox shows. *The Simpsons*, *House*, and *Prison Break* made the cut because they had "strong sonic brands," says Cook—recognizable voices and sounds. But when the team tried out a *House* character's signature phrase, "Hello, sick people!" it took up more than a second. When they added the reminder, "Tonight on Fox!"

Poole said, "it sounded like garbage, it was so fast."

Neither Fox nor Clear Channel will discuss the price of a blink. With a McDonald's campaign ("I'm Lovin' It" the wings, Clear Channel says it eventually hopes to reach 10% to 15% of its 60-second ad rate. Kaye Bentley, a senior vice-president at Fox, said Fox paid much less for its pilot round.

So far, says Elvis Dura, a deejay at Clear Channel station Z100 in New York, music lovers haven't complained about the blinks. "Listeners don't have time to get mad," he says.

—Aili McConnochie

## INN CROWD

## BOOKING A ROOM IN CYBERSPACE

**THINK OF IT** as a virtual focus group. **Starwood Hotels** is showcasing its newest hotel brand, **aloft**, in cyberspace, complete with a launch party on Sept. 18. The chain—which owns Sheraton, Westin, and W, among others—is now constructing a model of the hotel inside the world of Second Life, the virtual community

visited by users who create digital personas, or "avatars," to interact with one another.

Starwood's entry into Second Life will certainly build buzz about aloft, which will cater to design-conscious, tech-savvy travelers. Outfits like American Apparel, Universal Music, and even the American Cancer Society have already set up shop in this

cyberworld to push their brands. But the real payoff says aloft Vice-President Brian McGuinness, is the feedback about the hotel's progress from Second Life denizens, who post their reactions on SL's message boards. "It's the next generation of marketing," he says. Operated by Linden Lab, so far has about 595,000

"residents" (4 female, media 32). Behind the scenes, a wallet Starwood hopes will open when real aloft hotels launch in U.S. cities in '07.

—Diane Brady  
Aili McConnochie



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## ANALYZE THIS

BY KERRY SULKOWICZ, M.D.

# I'd Like to Postpone a Toast...

**I dread speaking before a group. I usually do fine, whether it's a formal presentation or a toast. But I spend way too much time preparing—memorizing every word—and feeling anxious. Any suggestions?**

—Anonymous, New York

**FIRST, REFLECT** on whether it's dread or something milder. A certain amount of nervousness about public speaking is normal, related to the pleasure that comes from performing well. If you're one of those so afflicted, life could be worse: The "cure" involves learning to tolerate the feeling.

If you're really in agony, though, the problem probably goes deeper. All that preparation doesn't dissipate the dread because there's a gap between what you consciously fear and what's rumbling deep down—whatever underlying meaning your mind attaches to performing in front of people. What if, for you, the audience is a stand-in for a parent who was impossible to please? Your anxiety might have less to do with the likelihood of flopping than with the threat that repressed anger about that parent will erupt. The podium then feels like a slippery slope on which you're in danger of losing control. (That might explain why you memorize every word.) There's also

the possibility that, for you, being in front of a group is tantamount to being an exhibitionist. It's one thing to reveal your knowledge of the budget. It's another to feel as if you're standing there naked.

Some introspection about the roots of your anxiety, with or without the assistance of a qualified shrink, can help a lot. Or if instant gratification is more your speed, consider asking your doctor to prescribe low-dose propranolol for those moments on stage. (More performers than you might imagine use these beta blockers.) Either of these solutions should give you relief. And you need some. High anxiety is tough to hide—and tougher to endure.

**Recently I participated with colleagues in a seminar led by corporate training experts. We were given roles and games to play. In one, we passed a ball across the room following silly and difficult rules. Even if I weren't a seasoned professional, I would have found this a**



**waste of time. What's the idea here?** —Nancy Stiefel

**THE IDEA**, usually, is to do some kind of team building. My impulse, too, is to dismiss such activities as fairly useless—often, they are. But they can have unintended value. When the exercises are nonsensical, for instance, colleagues bond by airing their gripes about them. You can also use the experience to observe your peers and your boss (if he or she has to show up, too). They reveal quite a lot about how they feel in their real jobs when they try on new, even imaginary, ones. Finally, try to understand

what your employer wants you to take away from such sessions. See if this matches what you got. If not, you might mention that to your boss—going easy on the cynicism.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executives on psychological aspects of business. Send questions at [analyzethis@businessweek.com](mailto:analyzethis@businessweek.com).

## QUESTION OF THE WEEK

As Ford struggles to stem its losses, CEO Bill Ford must decide how to restructure. With the idea now being floated that the carmaker should go private and potential buyers eyeing some of its brands, what should Ford do to be competitive again?

—David Kiley

**"The most important thing is to focus on brands Ford can sell to retail customers, not to employees and rental fleets. The brands to go forward with and invest in are Ford, Volvo, and Land Rover."**

Mike Jackson, CEO, AutoNation, the biggest Ford dealer in the U.S.

**"A CEO feeling the pull to run a great car company and the pull to maximize share price is a man divided. I wonder if Bill Ford asks himself what he'd do differently if he had only the banks to answer to."**

David Halberstam, author of *The Reckoning* (1986), about Detroit's shortsightedness

**"Ford should jettison Jaguar and Land Rover, keep Volvo and Aston Martin—and do everything in its power to resurrect Lincoln. Its mishandling of this iconic American luxury brand borders on the criminal."**

Peter DeLoraine, editor of *AutoExtremist.com*



# Is your cholesterol out of whack?

CRESTOR can get your bad cholesterol down. It can also get your good cholesterol up.

High blood pressure and diabetes are among factors that make it even more important to get your bad cholesterol low. But to get your cholesterol right, your doctor may also want your good cholesterol up. And diet and exercise alone may not be enough to lower the bad cholesterol and raise the good.

CRESTOR is a cholesterol medicine that does both.

A 10-mg dose of CRESTOR® (rosuvastatin calcium) along with diet, can lower bad cholesterol, LDL, by up to 52% (vs 7% with placebo). CRESTOR can also raise good cholesterol, HDL, by up to 14% (vs 3% with placebo). Your results may vary.

Down with the bad  Up with the good 

Is CRESTOR right for you? That's a conversation you need to have with your doctor.

#### Important safety information about CRESTOR:

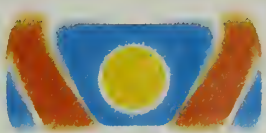
CRESTOR is prescribed along with diet for lowering high cholesterol and has not been determined to prevent heart disease, heart attacks, or strokes. CRESTOR is not right for everyone, including women who are nursing, pregnant, or who may become pregnant, or anyone with liver problems. Your doctor will do blood tests before and during treatment with CRESTOR to monitor your liver function. Unexplained muscle pain and weakness could be a sign of a rare but serious side effect and should be reported to your doctor right away. The 40-mg dose of CRESTOR is only for patients who do not reach goal on 20 mg. Be sure to tell your doctor if you are taking any medications. Side effects occur infrequently and include muscle aches, constipation, weakness, abdominal pain, and nausea. They are usually mild and tend to go away.

Please read the important Product Information about CRESTOR on the adjacent page.

*If you are without prescription coverage and can't afford your medication, AstraZeneca may be able to help.*

CRESTOR helps get your cholesterol right.

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rosuvastatin calcium

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Please read this summary carefully and then ask your doctor about CRESTOR. No advertisement can provide all the information needed to determine if a drug is right for you. This advertisement does not take the place of careful discussions with your doctor. Only your doctor has the training to weigh the risks and benefits of a prescription drug.

**BRIEF SUMMARY:** For full Prescribing Information, see package insert. **INDICATIONS AND USAGE:** CRESTOR is indicated: 1. as an adjunct to diet to reduce elevated total-C, LDL-C, ApoB, nonHDL-C, and TG levels and to increase HDL-C in patients with primary hypercholesterolemia (heterozygous familial and nonfamilial) and mixed dyslipidemia (Fredrickson Type IIa and IIb); 2. as an adjunct to diet for the treatment of patients with elevated serum TG levels (Fredrickson Type IV); 3. to reduce LDL-C, total-C, and ApoB in patients with homozygous familial hypercholesterolemia as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or if such treatments are unavailable. **CONTRAINDICATIONS:** CRESTOR is contraindicated in patients with a known hypersensitivity to any component of this product. Rosuvastatin is contraindicated in patients with active liver disease or with unexplained persistent elevations of serum transaminases (see WARNINGS, Liver Enzymes). **Pregnancy and Lactation:** Atherosclerosis is a chronic process and discontinuation of lipid-lowering drugs during pregnancy should have little impact on the outcome of long-term therapy of primary hypercholesterolemia. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they may cause fetal harm when administered to pregnant women. Therefore, HMG-CoA reductase inhibitors are contraindicated during pregnancy and in nursing mothers. ROSUVASTATIN SHOULD BE ADMINISTERED TO WOMEN OF CHILDBEARING AGE ONLY WHEN SUCH PATIENTS ARE HIGHLY UNLIKELY TO CONCEIVE AND HAVE BEEN INFORMED OF THE POTENTIAL HAZARDS. If the patient becomes pregnant while taking this drug, therapy should be discontinued immediately and the patient apprised of the potential hazard to the fetus. **WARNINGS:** **Liver Enzymes:** HMG-CoA reductase inhibitors, like some other lipid-lowering therapies, have been associated with biochemical abnormalities of liver function. The incidence of persistent elevations (>3 times the upper limit of normal [ULN] occurring on 2 or more consecutive occasions) in serum transaminases in fixed dose studies was 0.4, 0, 0, and 0.1% in patients who received rosuvastatin 5, 10, 20, and 40 mg, respectively. In most cases, the elevations were transient and resolved or improved on continued therapy or after a brief interruption in therapy. There were two cases of jaundice, for which a relationship to rosuvastatin therapy could not be determined, which resolved after discontinuation of therapy. There were no cases of liver failure or irreversible liver disease in these trials. It is recommended that liver function tests be performed before and at 12 weeks following both the initiation of therapy and any elevation of dose, and periodically (e.g., semiannually) thereafter. Liver enzyme changes generally occur in the first 3 months of treatment with rosuvastatin. Patients who develop increased transaminase levels should be monitored until the abnormalities have resolved. Should an increase in ALT or AST of >3 times ULN persist, reduction of dose or withdrawal of rosuvastatin is recommended. Rosuvastatin should be used with caution in patients who consume substantial quantities of alcohol and/or have a history of liver disease (see CLINICAL PHARMACOLOGY, Special Populations, Hepatic Insufficiency). Active liver disease or unexplained persistent transaminase elevations are contraindications to the use of rosuvastatin (see CONTRAINDICATIONS). **Myopathy/Rhabdomyolysis:** Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with rosuvastatin and with other drugs in this class. Uncomplicated myalgia has been reported in rosuvastatin-treated patients (see ADVERSE REACTIONS). Creatine kinase (CK) elevations (>10 times upper limit of normal) occurred in 0.2% to 0.4% of patients taking rosuvastatin at doses up to 40 mg in clinical studies. Treatment-related myopathy, defined as muscle aches or muscle weakness in conjunction with increases in CK values >10 times upper limit of normal, was reported in up to 0.1% of patients taking rosuvastatin doses of up to 40 mg in clinical studies. In clinical trials, the incidence of myopathy and rhabdomyolysis increased at doses of rosuvastatin above the recommended dosage range (5 to 40 mg). In postmarketing experience, effects on skeletal muscle, e.g., unexplained myalgia, myopathy, and, rarely, rhabdomyolysis have been reported in patients treated with HMG-CoA reductase inhibitors including rosuvastatin. As with other HMG-CoA reductase inhibitors, reports of rhabdomyolysis with rosuvastatin are rare, but higher at the highest marketed dose (40 mg). Factors that may predispose patients to myopathy with HMG-CoA reductase inhibitors include advanced age (>65 years), hypothyroidism, and renal insufficiency. Consequently: 1. Rosuvastatin should be prescribed with caution in patients with predisposing factors for myopathy, such as, renal impairment (see DOSAGE AND ADMINISTRATION), advanced age, and inadequately treated hypothyroidism. 2. Patients should be advised to promptly report unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. Rosuvastatin therapy should be discontinued if markedly elevated CK levels occur or myopathy is diagnosed or suspected. 3. The 40 mg dose of rosuvastatin is reserved only for those patients who have not achieved their LDL-C goal utilizing the 20 mg dose of rosuvastatin once daily (see DOSAGE AND ADMINISTRATION). 4. The risk of myopathy during treatment with rosuvastatin may be increased with concurrent administration of other lipid-lowering therapies or cyclosporine. (see CLINICAL PHARMACOLOGY, Drug Interactions, PRECAUTIONS, Drug Interactions, and DOSAGE AND ADMINISTRATION). The benefit of further alterations in lipid levels by the combined use of rosuvastatin with fibrates or niacin should be carefully weighed against the potential risks of this combination. Combination therapy with rosuvastatin and gemfibrozil should generally be avoided. (see DOSAGE AND ADMINISTRATION and PRECAUTIONS, Drug Interactions). 5. The risk of myopathy during treatment with rosuvastatin may be increased in circumstances which increase rosuvastatin drug levels (see CLINICAL PHARMACOLOGY, Special Populations, Race and Renal Insufficiency, and PRECAUTIONS, General). 6. Rosuvastatin therapy should also be temporarily withheld in any patient with an acute, serious condition suggestive of myopathy or predisposing to the development of renal failure secondary to rhabdomyolysis (e.g., sepsis, hypotension, dehydration, major surgery, trauma, severe metabolic, endocrine, and electrolyte disorders, or uncontrolled seizures). **PRECAUTIONS:** **General:** Before instituting therapy with rosuvastatin, an attempt should be made to control hypercholesterolemia with appropriate diet and exercise, weight reduction in obese patients, and treatment of underlying medical problems (see INDICATIONS AND USAGE). Administration of rosuvastatin 20 mg to patients with severe renal impairment ( $Cl_{CR} < 30$  mL/min/1.73 m<sup>2</sup>) resulted in a 3-fold increase in plasma concentrations of rosuvastatin compared with healthy volunteers (see WARNINGS, Myopathy/Rhabdomyolysis and DOSAGE AND ADMINISTRATION). The result of a large pharmacokinetic study conducted in the US demonstrated an approximate 2-fold elevation in median exposure in Asian subjects (having either Filipino, Chinese, Japanese, Korean, Vietnamese or Asian-Indian origin) compared with a Caucasian control group. This increase should be considered when making rosuvastatin dosing decisions for Asian patients. (See WARNINGS, Myopathy/Rhabdomyolysis; CLINICAL PHARMACOLOGY, Special Populations, Race, and DOSAGE AND ADMINISTRATION.) **Information for Patients:** Patients should be advised to report promptly unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. When taking rosuvastatin with an aluminum and magnesium hydroxide combination antacid, the antacid should be taken at least 2 hours after rosuvastatin administration (see CLINICAL PHARMACOLOGY, Drug Interactions). **Laboratory Tests:** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg, when compared to lower doses of rosuvastatin or comparator statins, though it was generally transient and was not associated with worsening renal function. Although the clinical significance of this finding is unknown, a dose reduction should be considered for patients on rosuvastatin 40 mg therapy with unexplained persistent proteinuria during routine urinalysis testing. **Drug Interactions:** **Cyclosporine:** When rosuvastatin 10 mg was coadministered with cyclosporine in cardiac transplant patients, rosuvastatin mean  $C_{max}$  and mean AUC were increased 11-fold and 7-fold, respectively, compared with healthy volunteers. These increases are considered to be clinically significant and require special consideration in the dosing of rosuvastatin to patients taking concomitant cyclosporine (see WARNINGS, Myopathy/Rhabdomyolysis,

and DOSAGE AND ADMINISTRATION). **Warfarin:** Coadministration of rosuvastatin to patients on stable warfarin therapy resulted in clinically significant rises in INR (>4, baseline 2-3). In patients taking coumatin anticoagulants and rosuvastatin concomitantly, INR should be determined before starting rosuvastatin and frequently enough during early therapy to ensure that no significant alteration of INR occurs. Once a stable INR time has been determined, INR can be monitored at the intervals usually recommended for patients on coumatin anticoagulants. If the dose of rosuvastatin is changed, the same procedure should be repeated. Rosuvastatin therapy has not been associated with bleeding or with changes in INR in patients not taking coumatin anticoagulants. **Gemfibrozil:** Coadministration of a single rosuvastatin dose to healthy volunteers on gemfibrozil (600 mg twice daily) resulted in a 2.2- and 1.9-fold, respectively, increase in mean  $C_{max}$  and mean AUC of rosuvastatin (see DOSAGE AND ADMINISTRATION). **Endocrine Function:** Although clinical studies have shown that rosuvastatin alone does not reduce basal plasma cortisol concentration or impair adrenal reserve, caution should be exercised if any HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered concomitantly with drugs that may decrease the levels or activity of endogenous steroid hormones such as ketoconazole, spiroglactone, and cimetidine. **CNS Toxicity:** CNS vascular lesions, characterized by perivascular hemorrhages, edema, and mononuclear cell infiltration of perivascular spaces, have been observed in dogs treated with several other members of this drug class. A chemically similar drug in this class produced dose-dependent optic nerve degeneration (Wallerian degeneration of retinogeniculate fibers) in dogs, at a dose that produced plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose. Edema, hemorrhage, and partial necrosis in the interstitium of the choroid plexus was observed in a female dog sacrificed moribund at day 24 at 90 mg/kg/day by oral gavage (systemic exposures 100 times the human exposure at 40 mg/kg/day based on AUC comparisons). Corneal opacity was seen in dogs treated for 52 weeks at 40 mg/kg/day by oral gavage (systemic exposures 20 times the human exposure at 40 mg/kg/day based on AUC comparisons). Cataracts were seen in dogs treated for 12 weeks by oral gavage at 30 mg/kg/day (systemic exposures 60 times the human exposure at 40 mg/kg/day based on AUC comparisons). Retinal dysplasia and retinal loss were seen in dogs treated for 4 weeks by oral gavage at 90 mg/kg/day (systemic exposures 100 times the human exposure at 40 mg/kg/day based on AUC). Doses  $\leq 30$  mg/kg/day (systemic exposures  $\leq 60$  times the human exposure at 40 mg/kg/day based on AUC comparisons) following treatment up to one year, did not reveal retinal findings. **Carcinogenesis, Mutagenesis, Impairment of Fertility:** In a 104-week carcinogenicity study in rats at dose levels of 2, 20, 60, or 80 mg/kg/day by oral gavage, the incidence of uterine stromal polyps was significantly increased in females at

patients in placebo-controlled clinical studies of rosuvastatin are shown in Table 1; discontinuations due to adverse events in these studies of up to 12 weeks duration occurred in 3% of patients on rosuvastatin and 5% on placebo.

Table 1. Adverse Events in Placebo-Controlled Studies

| Adverse event           | Rosuvastatin<br>N=744 | Placebo<br>N=382 |
|-------------------------|-----------------------|------------------|
| Pharyngitis             | 9.0                   | 7.6              |
| Headache                | 5.5                   | 5.0              |
| Diarrhea                | 3.4                   | 2.9              |
| Dyspepsia               | 3.4                   | 3.1              |
| Nausea                  | 3.4                   | 3.1              |
| Myalgia                 | 2.8                   | 1.3              |
| Asthenia                | 2.7                   | 2.6              |
| Back pain               | 2.6                   | 2.4              |
| Flu syndrome            | 2.3                   | 1.8              |
| Urinary tract infection | 2.3                   | 1.6              |
| Rhinitis                | 2.2                   | 2.1              |
| Sinusitis               | 2.0                   | 1.8              |

In addition, the following adverse events were reported, regardless of causality assessment  $\geq 1\%$  of 10,275 patients treated with rosuvastatin in clinical studies. The events in italics are  $\geq 2\%$  of these patients. **Body as a Whole:** Abdominal pain, accidental injury, chest pain, pain, pelvic pain, and neck pain. **Cardiovascular System:** Hypertension, angina pectoris, vasodilation, and palpitation. **Digestive System:** Constipation, gastroenteritis, vomiting, flatulence, periodontal abscess, and gastritis. **Endocrine:** Diabetes mellitus. **Hemic and Lymphatic System:** Anemia and ecchymosis. **Metabolic and Nutritional Disorders:** Peripheral neuropathy. **Musculoskeletal System:** Arthritis, arthralgia, and pathological fracture. **Nervous System:** Dizziness, insomnia, hypertension, paresthesia, depression, anxiety, vertigo, and syncope. **Respiratory System:** Bronchitis, cough increased, dyspnea, pneumonia, and asthma. **Appendages:** Rash and pruritus. **Laboratory Abnormalities:** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg compared to lower doses of rosuvastatin or comparator statins, though it was generally transient and was not associated with worsening renal function. (see PRECAUTIONS, Laboratory Tests). Other abnormal laboratory values reported were elevated creatine phosphokinase, alkaline phosphatase, hyperglycemia, glutamyl transaminase, alkaline phosphatase, bilirubin, and function abnormalities. Other adverse events reported less frequently than 1% in the rosuvastatin clinical study program, regardless of causality assessment, included arrhythmia, hepatitis, sensitivity reactions (i.e., face edema, thrombocytopenia, leukopenia, vesiculobullous eruptions, urticaria, and angioedema), kidney failure, syncope, myasthenia, myositis, pancreatitis, paresthesia, reaction, myopathy, and rhabdomyolysis. **Postmarketing Experience:** In addition to the events reported above, as with other drugs in this class, the following event has been reported during post-marketing experience with CRESTOR, regardless of causality assessment: very rare cases of jaundice. **OVERDOSAGE:** There is no specific treatment in the event of overdose. In the event of overdose, the patient should be treated symptomatically and supportive measures instituted as required. Hemodialysis does not significantly enhance clearance of rosuvastatin. **DOSAGE AND ADMINISTRATION:** The patient should be placed on a low cholesterol-lowering diet before receiving CRESTOR and should continue on this diet during treatment. CRESTOR can be administered as a single dose at any time of day, with or without food. **Hypercholesterolemia (Heterozygous Familial and Nonfamilial):** The recommended starting dose of CRESTOR is 20 mg once daily. The dose range for mixed dyslipidemia (Fredrickson Type IIa and IIb) is 5 to 40 mg once daily. Therapy with CRESTOR should be individualized according to the patient's response and the usual recommended starting dose of CRESTOR is 10 mg once daily. However, initiation of therapy with 5 mg once daily should be considered for patients requiring aggressive LDL-C reductions, who have predisposing factors for myopathy, and as noted in special populations such as patients taking cyclosporine, Asian patients, and patients with renal insufficiency (see CLINICAL PHARMACOLOGY, Race, and Renal Insufficiency). Interactions. For patients with marked hypercholesterolemia (LDL-C  $\geq 190$  mg/dL) and lipid targets, a 20-mg starting dose may be considered. After initiation and/or upon CRESTOR, lipid levels should be analyzed within 2 to 4 weeks and dosage adjusted. The 40-mg dose of CRESTOR is reserved only for those patients who have not achieved their LDL-C goal utilizing the 20 mg dose of CRESTOR once daily (see WARNINGS, Myopathy/Rhabdomyolysis). When initiating statin therapy or switching from another statin to appropriate CRESTOR starting dose should first be utilized, and only then titrated to the patient's individualized goal of therapy. **Homozygous Familial Hypercholesterolemia:** The recommended starting dose of CRESTOR is 20 mg once daily with homozygous FH. The maximum recommended daily dose is 40 mg. CRESTOR should be used in these patients as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) if such treatments are unavailable. Response to therapy should be estimated from pre-apheresis levels. **Dosage in Asian Patients:** Initiation of CRESTOR therapy with 5 mg should be considered for Asian patients. The potential for increased systemic exposure in Caucasians is relevant when considering escalation of dose in cases where hypercholesterolemia is not adequately controlled at doses of 5, 10, or 20 mg once daily. (See WARNINGS, Myopathy/Rhabdomyolysis; CLINICAL PHARMACOLOGY, Special Populations, Race, and PRECAUTIONS, General.) **Dosage in Patients Taking Cyclosporine:** In patients taking cyclosporine, therapy should be limited to CRESTOR 5 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Concomitant Lowering Therapy:** The effect of CRESTOR on LDL-C and total-C may be enhanced in combination with a bile acid binding resin. If CRESTOR is used in combination with gemfibrozil, the dose of CRESTOR should be limited to 10 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Dosage in With Renal Insufficiency:** No modification of dosage is necessary for patients with moderate renal insufficiency. For patients with severe renal impairment ( $Cl_{CR} < 30$  mL/min/1.73 m<sup>2</sup>) or on hemodialysis, dosing of CRESTOR should be started at 5 mg once daily and should not exceed 10 mg once daily (see PRECAUTIONS, General, and CLINICAL PHARMACOLOGY, Special Populations, Renal Insufficiency).

**NOTE:** This summary provides important information about CRESTOR. For more information, please ask your doctor or health care professional about the full Prescribing Information for CRESTOR.

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# What's Your Problem?

WITH THIS ISSUE, we welcome a new columnist: Kerry Sulkowicz, M.D., a psychiatrist and psychoanalyst who is also a leading corporate consultant. A Texan who migrated to New York (where he is a clinical professor of psychiatry at NYU School of Medicine), Kerry counsels executives and entrepreneurs all over the country as part of his work with Boswell Group, a consulting firm he founded to focus on the psychology of business.



Analyze This, his *BusinessWeek* column (page 14), will tackle your questions about how to handle the emotional dynamics of work. From time to time, it will also look generally at the business mind—the psychological underpinnings of, say, an ad campaign or an unfolding corporate crisis.

Of course, a 50-line answer can't

make a problem disappear, any more than a 50-minute hour can. The idea is to offer an insight, a start. Kerry has experience with this kind of distillation. He wrote the monthly Corporate Shrink column at *Fast Company* and is the author of *Shrink Inc.: Self-Awareness as the Ultimate Business Strategy*, to be published by Random House in 2007.

His column will appear every other week in the magazine's newly expanded Up Front section. Send your questions to [analyzethis@businessweek.com](mailto:analyzethis@businessweek.com). The doctor is in.

*Stephen J. Adler*

EDITOR-IN-CHIEF

## VISCERAL RESPONSES TO THE "VALLEY BOYS"

A SCANT SIX YEARS after the tech crash of 2000, *BusinessWeek* is once again falling into the same old trap ("Valley Boys," Cover Story, Aug. 14). Instead of touting real examples of creative entrepreneurship on your cover, you hyped yet another Web startup with anemic revenues and no appreciable business model. Numerous Web 2.0 darlings have already crashed and burned. Your publication should have asked the question that continues to plague all Web 2.0

businesses: How can a Web site that is entirely predicated on user-submitted content ever hope to survive?

—Mark Longo  
Chicago

AS MUCH AS I enjoyed the latest account of how the dynamics behind Silicon Valley entrepreneurship are changing, I was deeply alarmed by the role that women are consigned to play in the article. If there is a lack of female tech entrepreneurs, the writers and editors of the article are certainly not at fault. But why should *Busi-*

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# ReadersReport

*nessWeek* validate the misguided perception that access to "pretty girls" is a benchmark on the ladder of success?

To emphasize the "rock star"-like status of so-called Valley Boys like Kevin Rose, readers are told that he was seen signing the cleavage of a "pretty brunette" at a party. This unnecessary detail, juxtaposed with other perks of his success, just reinforces the notion of women as prizes for successful entrepreneurs, rather than colleagues and competitors.

—Zoe Brooks  
New York

BUBBLE 2.0 is nearing its bursting point. A puff piece like the glowing BW quasi-press release for Digg.com suggests that Webvan, Pets.com, and Boo.com will soon be on their summer revival tour.

—Archie Senor Hall  
New York

## THE NATIONAL SLAVERY MUSEUM'S CIRCUITOUS ROUTE TO REALITY

DOUGLAS WILDER'S National Slavery Museum is very long overdue ("A cause that scares business," *Philanthropy*, Aug. 14). I urged President Clinton during his first term to donate land and re-

sources for such an institution memorializing this monstrous mega-crime, which took millions of lives during the passage across the Atlantic and in slaves' workplaces. To no avail.

Now Mr. Wilder is having difficulty raising the necessary funds for this important educational project. Here is a proposal: The same good people of all backgrounds who founded the United States Holocaust Memorial Museum in Washington, D.C., with private donations and the resources of the federal government can make the Slavery Museum a reality.

It would be an historic tribute to the unpaid labors and terrible suffering of African American slaves who harvested the food, took care of others' children, and built much of America, including the U.S. Capitol itself, during those two and a half centuries.

—Ralph Nader  
Washington

WHY IS THE United States National Slavery Museum being built in Fredricksburg, Va., instead of Washington, on our National Mall? I can answer this question. Most white Americans in this great nation are in denial of the devastating impact

slavery and racism continue to have America. Why put it in our own backyard?

—Pamela A. Hairs  
Washington

## A LITTLE WAGE INFLATION WOULD BE WELCOME

REGARDING "INVESTORS may be celebrating too soon" (*Business Outlook*, Aug. 14): Would a little wage inflation really be so bad? I understand labor's share of corporate profits are at relatively historic lows and the real wage has generally stagnated or fallen for some time now (with, I believe, a brief reprieve in the '90s). Maybe workers could finally have a chance to have their wages keep up with the nominal price increases we have been experiencing lately.

—Andrew Harrison  
Cambridge, MA

## A BLADE TOO FAR—FOR SOME SHAVERS, AT LEAST

I READ DAN BEUCKE'S comment ("A blade too far," *News & Insights*, Aug. 14) on the Gillette Fusion razor with amusement. My wife and children tease me about my ever-increasing razor collection; as a new "cutting edge" razor



Knowing where you're going is fine, but strength and determination will get you there. rbs.com

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comes out, I'm one of the first to run and buy it. Like Beucke, they seem miss the point. To some extent, the able razor is a utility device, used for onal grooming. It should be functional and, let's face it, there's a limit to number of ways to trim whiskers. to many people, the razor goes bel that, and that is the market ette has tapped.

razor is also a toy. Shaving every ning can be dull work, and for those looking to vary our morning routine, w toy is welcome. A shiny color, more es, a vibrating handle—why, the Fu-even has an indicator light to tell you battery is running low! But the best g about this new toy is that most of us afford it. Sure, \$40 (with a bunch of es) is more than cheap razors cost, t's a lot less than just one ticket to a or League Baseball game.

—Robert D. Grossman  
Egg Harbor Township, N.J.

R BLADES, five blades, six blades.... t's next, a lawnmower? Here's a nov-a: How about making one blade that uly works? One hundred years ago, te advertised a razor that could get

100 uses. Revolutionary. In the meantime, I'll keep using the generics.

—Paul Marino  
New York

I'M AN OLD MAN of 86, and I use a single-blade razor of pre-World War I vintage—my father's safety razor. I carried it as a combat infantryman during my World War II adventure in France and Germany. I was superstitious and had the idea it would be good luck. Being a survivor of the Great Depression, when a penny had some value and you learned to

#### CORRECTIONS & CLARIFICATIONS

"Fixing Ford is now Job One" (News & Insights, Sept. 4) stated that Ford Motor Co. has racked up \$9 billion in losses and restructuring charges since 2001. It should have clarified that the losses and restructuring charges are for its North American business.

In the Aug. 14 Readers Report letter "Seeing cracks in the VA's medical model," we misread retired Col. S.J. Hazan's signature. He was in the U.S. Army Medical Corps, not the U.S. Marine Corps.

get by with the bare essentials, I would be able to reuse the Gillette blades many times by simply resharpener the double-edged blade. The only tool needed was an average-size water glass. With one finger pressing on the blade on the inside of the glass and seesawing back and forth on the rounded surface, it would be as good as new. So much for advanced science.

—Robert J. Straba  
Albuquerque

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# The Truth about Fiery Laptops

The recall of nearly 6 million Dell and Apple laptop batteries brought to light what has long been the tech industry's dirty little secret: The batteries that power our laptops, wireless phones, iPods, and cameras are potential incendiaries. The risk of your laptop bursting into flames is low, and it is much lower for other devices. But it is real, and it's not going away.

The lithium ion batteries that came into widespread use in the late 1990s enabled a revolution in portable electronics by allowing a lot of power to be packed into a very small space. But if you overcharge them, or there is an electrical fault such as a short circuit, they can generate an unfortunate combination of oxygen, fuel, and heat inside the cells—in other words, an explosive fire waiting to happen.

Lithium ion batteries and their cousins, the lithium polymer batteries used mainly in phones and other handhelds, rely on protective electronics to prevent chemical mayhem. Of the millions of batteries Sony made for Dell and Apple, these circuits appear to have failed in several dozen, sparking fires that can be contained but not extinguished until the oxygen and fuel are spent. Physical damage to the battery can cause the same results. Laptops are far more prone to catch fire than other products because their batteries are much larger and operate in a much hotter environment, heat being an important contributing factor.

**DESPITE THE INHERENT RISKS**, lithium ion batteries aren't going away any time soon because there are no good alternatives. But the dangers are having consequences, beyond the financial damage to the companies involved in the recalls. One is that we have hit the wall in increasing the efficiency of batteries—at least as measured in watts per kilogram or watts per liter—because without some major chemical breakthrough, higher power densities would cause unacceptable hazards. Making batteries larger is also not an option. The International Air Transport Assn. will not allow batteries containing more than 8 grams of lithium aboard passenger aircraft. The largest laptop batteries used today have hit that limit.

**Lithium ion batteries are potential incendiaries, but they're all we've got**



An Austin (Tex.) company called Valence Technology does make a lithium battery with different chemistry that is safe because its reactions don't produce fire-sustaining oxygen. The downside is that these batteries provide less power for a given size and weight. They are being used as battery backups for cell towers and could well appear in the next generation of hybrid cars, which are currently powered by safe but less efficient nickel metal hydride batteries.

With no breakthroughs in battery technology on the horizon, researchers at companies such as Toshiba and Matsushita are pursuing methanol fuel cells as an alternative. But so far, nobody has been able to develop cells that can meet the power needs of laptops, fit in the space now occupied by a battery, and be cheap enough to be competitive.

Even if such cells existed, we would need a distribution system to make cartridges of the liquid fuel available everywhere. And while the International Civil Aviation Organization has approved their use aboard commercial aircraft, the methanol cartridges are unlikely to muster with the U.S. Transportation Security Administration.

So we are stuck with lithium ion batteries for the foreseeable future, but there are a few things you can do to make them safer. One is to treat

batteries gently and protect them from overheating. Fire is much more likely while the battery is charging. If you run a laptop on in-seat power on an airplane or train, do everything you can to avoid it and remove the battery during your journey.

Fires have been rare enough that batteries, other than defective ones being recalled, do not pose an unreasonable risk. But they are dangerous enough that the industry should step up its efforts to find a safer alternative. ■

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# The Strange Case of lonelygirl15

The summer's best TV show wasn't on TV, and this year's most compelling pop-culture guessing game didn't come courtesy of *Lost*. Meet YouTube lonelygirl15, also known as Bree, and her best (and only) pal, the schlump Daniel. The two have been starring in videos posted to YouTube since mid-June. But already lonelygirl15's videos have each been watched hundreds

of thousands of times. Her YouTube "channel" is the second most subscribed to of all time, and each video elicits thousands of viewer comments. Bree and Daniel are proof that a secret-handshake-styled series of short videos can be a bona fide hit.

As of late August, Bree's and Daniel's videos run a mere 45 minutes when laid end to end. They are earnest, goofy, chaste (Daniel's crush is thus far unrequited), narrated in tight close-up, and largely set in Bree's bedroom. They focus on time-honored teen themes: parental conflicts, social isolation, boy and girl troubles. They are, as the stats suggest, hideously addictive. There are at least two fan sites, and a casual blog search reveals references to lonelygirl15 in six languages, including Russian.

**ALAS, THE BOOKISH AND CUTE BREE** is not real. Or at least not what she purports to be, which is a 16-year-old homeschooled daughter of strict parents who are intensely involved with a never-identified religion. A hot and damn-near obsessive debate about all this is playing out in video responses posted to YouTube, in the comment sections of Bree's and Daniel's videos, and on countless blogs.

Early chatter suggested a few theories: The videos were a corporation's viral marketing campaign; a teaser for an unknown major entertainment property; or something dreamed up by an obscure Christian sect, occultists, or Scientologists. (Spending time with the online debate over lonelygirl15 gets grassy-knoll very quickly.) It is a measure of the characters' appeal and the strength of this behind-the-curtain-of-teen-angst narrative that even one of their earlier debunkers now thinks the saga may be real. "If this is marketing, they are [expletive] brilliant," says Stephen Hill, who, as YouTube user gohepcat, video-blogged his suspicions of lonelygirl15's sharp lighting and seamless dialogue. "I've never seen anything go on for weeks without people being able to pull it apart."



**YOUTUBE STARS**  
"Bree" and  
"Daniel" have  
bloggers abuzz

At least, I think the I phoned was gohepcat. He sounded like the guy on those videos and denied being in on any fakery. But you never know with these things you're drawn into conjectures and clue-searches which make videos that much more interesting. (Ask any

Beatles fan who spun records backward seeking clues that Paul was dead.) So assume that Stephen is real.

As for lonelygirl15, sadly, no way. Based on comments from media and talent agents

executives, the videos appear to be produced by a small collection of creative types. They have had discussions with at least one major media company. Agents are pursuing them as well. (They should be aware that in real life Bree's name is not Jane.) Repeated messages sent to Daniel's and Bree's YouTube addresses yielded one brief e-mail, signed Bree, which politely stated: "I have decided not to do any interviews." The name in the e-mail header, though, was Jane Jones, which—bloggers, alert!—could be a clue, were the name not so close to Jane.

None of this, by the way, affects the genius-in-miniature of the ongoing lonelygirl15 saga, or its triumph as a new form of pop. The longest video is but 3:29, or the length of a pop song. Lyrics of pop songs are avidly deconstructed, so are all aspects of Daniel's and Bree's friendship and every bit of décor in Bree's room. The native teen awkwardness portrayed in the videos is exacerbated, in very 21st century fashion, by the airing their sides of arguments to YouTube viewers before calling or speaking with each other. At one point Bree suggests this whole putting personal videos up on the Internet thing wasn't such a good idea." Bree, or whatever your name is and whatever your affiliation may be: You're wrong. D stop. No soap opera was ever this good. ■

**BusinessWeek online** For Jon Fine's blog on media and advertising go to [www.businessweek.com/innovate/FineOnMedia](http://www.businessweek.com/innovate/FineOnMedia)





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JAMES C. COOPER

# Picking Up the Slack From Housing

Capital spending should contribute strongly to second-half growth

**U.S. ECONOMY** With all the attention the housing slump has garnered recently, another sector crucial to the economy's future performance has received short shrift: capital spending by businesses on new equipment and structures. Companies continue to show strong signs they are eager to expand their operations. Those outlays,

along with the production, jobs, and income they create, are expected to be a key factor keeping the economy chugging in the second half even as housing weakens.

In fact, the overall outlook is playing out largely as most forecasters had envisioned at the start of the year. The main theme was a shift in the sectors contributing to growth: less from households, more from businesses. As housing and consumer spending slowed, capital spending and exports would take up some of the slack. In reality, housing has been even weaker than expected, but the rest of the economy has been surprisingly resilient. For example, after incorporating more complete data, the Bureau of Economic Analysis (BEA) says overall growth in the second quarter was a bit stronger than first reported. The gross domestic product grew at a healthy 2.9% annual rate in the second quarter, up from the original estimate of 2.5%. The BEA also said corporate profits were strong, and it revised sharply higher the growth of workers' income.

Soundings on business outlays for equipment have a concern that cropped up in last quarter's GDP breakdown. Those numbers showed a dip in spending on machinery and high-tech hardware and software. However, new orders have rebounded in recent months, putting that sector in a position to contribute strongly to third-quarter GDP growth.

Businesses are also investing in new factory and office buildings at a rapid rate. Business construction is emerging from a slump that began with the tech bust in 2000 and continued until a solid recovery began last year (p. 10). In recent months outlays have accelerated, and the BEA now says spending for new structures surged at a 12% annual rate in the second quarter. The increase is nearly double the earlier estimate and the strongest quarterly advance in 12 years. After a dearth of new building, businesses are playing catch-up in the effort to meet demand for their products.

**AMERICAN BUSINESSES** are getting support from a number of sources. Most important, demand at home is picking up, and exports are booming amid robust growth overseas. U.S. consumers were clearly bummed out in August by new Mideast turmoil, the terrorism plot

unveiled in London, and high gas prices. The Conference Board's index of consumer confidence fell from 107 in July to 99.6 in August, the largest monthly drop since Hurricane Katrina and the lowest level of the year.

Still, spending signals so far show household buying got off to a good start this quarter, and the negative factors that depressed August confidence have subsided

going into September. In particular, retail gasoline prices fell from a national average of \$3.04 per gallon in early August to \$2.85 at the end of the month, and wholesale gas prices plummeted by 24%. If the wholesale price stays at about \$1.85 per gallon, pump prices could fall as much as 40¢ more by the end of

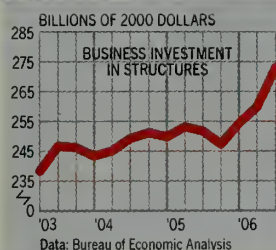
September, a drop that would boost household buying power significantly at a time when labor income is picking up.

Perhaps the most important revision to last quarter's GDP numbers was a sharp upward refiguring of workers' income from wages, salaries, and benefits in both the first and second quarters. The BEA now says overall compensation last quarter, originally up 6.8% from a year ago, has grown 8.3%. That increase is double the rate of inflation and close to the booming pace seen in 2000.

Steady demand is pressuring existing production facilities as businesses try to keep up. The best example is the industrial sector. After a long period of stagnation, the growth of production capacity is picking up again, but over the past year it has grown only 1.9%. Industrial output, up 4.9%, is increasing 2½ times faster. As a result, the average operating rate—the amount of capacity in use—has risen to a six-year high of 82.4% in July, a level that easily justifies adding on new capacity.

**FOR MANY COMPANIES**, financing their expansion is a no-brainer. With profits still soaring through the second quarter, cash flow is at record levels, and many outfits can

## BUSINESSES SHELL OUT FOR NEW CONSTRUCTION





finance their growth needs out of their internally generated funds. The BEA's economywide measure of corporate profits shows second-quarter earnings up a strong 20.5% from a year ago, the largest such advance in two years, although profit margins were squeezed a bit by rising labor and energy costs.

Even if profits slow as expected in the second half and companies' borrowing requirements pick up, the credit markets are still friendly and banks continue to welcome new business. For example, the spread between yields on moderately risky corporate bonds and riskless Treasury securities is lower than it was at the beginning of the year. A narrow spread indicates the credit markets attach only small risk to such borrowing. Borrowing rates themselves remain attractively low at about 6.4% for Standard & Poor's-rated BBB securities, up from 5.6% this time last year, but still well below the 7% average over the past decade.

Based on the Federal Reserve's latest survey of senior loan officers, banks on balance further eased their lending standards on commercial and industrial loans to large and midsize companies at the start of the third quarter. Despite the Fed's 17 quarter-point rate hikes since June, 2004, banks have continued to ease their terms and conditions over that entire period.

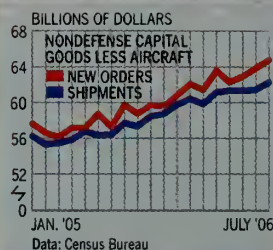
**THE NEED AND ABILITY** to expand operations is evident in the recent monthly data on capital-goods orders and shipments. In July orders for equipment exclusive of the big swings in the defense and commercial aircraft sectors,

which can distort the underlying trend, increased for the third month in a row (chart). Orders for computers and electronic products were especially strong in June and July, and so far this year they are growing faster than they did for all of 2005.

The trend in capital-goods orders is a key on-the-

ground gauge of business confidence, since orders represent future financial commitments. Both orders and shipments of capital goods began the third quarter well above their second-quarter levels, and the backlog of unfilled orders keeps swelling. The backlog is up 14.2% from a year ago and measured at an annual rate it has grown

## NO LETUP IN DEMAND FOR CAPITAL GOODS



at an even faster pace in recent months.

With plenty of production and shipments in the pipeline, capital spending is set to be a key source of economic strength in the second half. Business investment in new plants and equipment directly accounts for more than twice as much GDP as housing. While housing has broad indirect influence on the economy, the impact of capital spending may be even more important: As businesses invest more and expand their operations, they generate more jobs and income for consumers. ■

## HOUSING

# The Slump Begins to Hit Payrolls

**THE HOUSING** market's decline is moving on to the next stage. As home sales and construction activity deteriorate at a faster pace, job growth in areas linked to residential real estate is starting to ebb and even decline outright in some parts of the country where the housing boom has been the strongest.

State employment data show that construction payrolls in California have fallen by more than 11,000 workers during the six months through July. The number of construction workers in Massachusetts, Connecticut, and New Jersey has also fallen over the same period. Meanwhile, hiring in other housing hot spots, such as Maryland, Oregon,

and Virginia, is beginning to slow.

When it comes to work in other fields related to real estate, state data are more limited, but they do show some areas where growth is flagging. Among real estate agents and brokers in California, hiring in July cooled to a 4.8% gain from a year ago. That rise is below the 7.8% national pace as of July and is the smallest gain in the state since August, 2002. Hiring in

Oregon for real estate-related financial activities increased 1.5% from a year ago in July, a significant slowdown from last July's 9.5% pace.

The state data are in line with recent trends in the national job figures. According to investment bank UBS, residential housing payrolls,

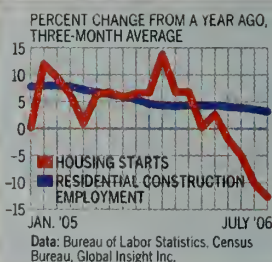
which includes construction, financial, retail, and professional services positions, declined by a total of 15,000 jobs in June and July.

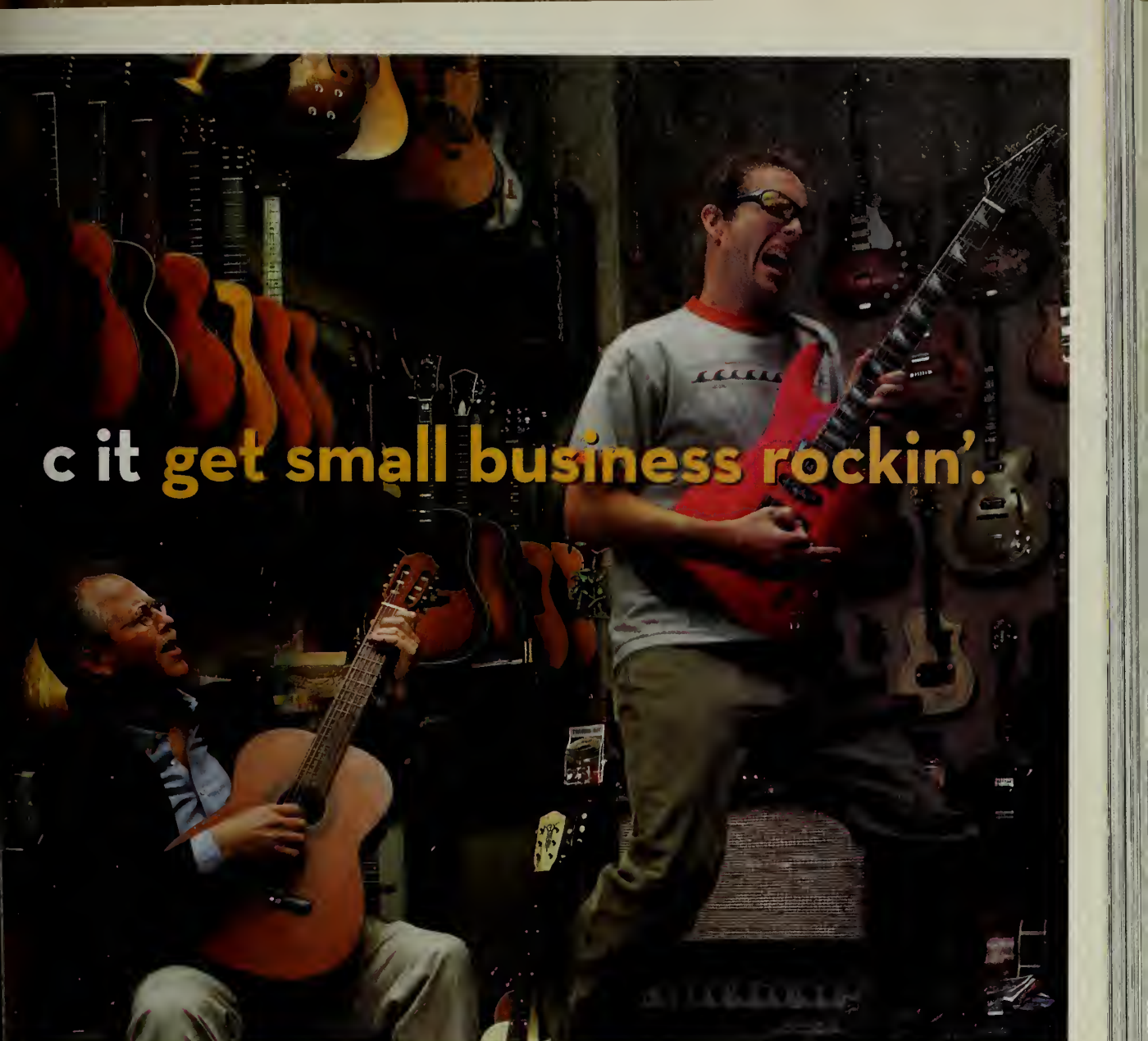
The job market for residential construction could turn south more quickly now. July new home sales housing starts posted the sharpest yearly drops since the mid-1990s, with big declines coming in the over-hot West and Northeast. Other jobs linked to housing will also decline. The Federal Reserve's July survey of banks showed the large share of lenders reporting a drop in mortgage demand since early 2006.

For states such as California, Maryland, and Virginia that experienced the hottest housing markets, the bust may be doubly painful since construction jobs accounted for a disproportionate part of total job growth during the boom. ■

—By James Mehring in New

## CONSTRUCTION JOBS LOSE THEIR FOOTING



A photograph of two men in a music store. One man is standing and playing a red electric guitar, wearing sunglasses and a grey t-shirt. The other man is sitting and playing an acoustic guitar, wearing a dark jacket over a light shirt. The background is filled with various guitars hanging on the wall.

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# The Business Week

## News you need to know

EDITED BY HARRY MAURER

**Statistics as Weapons** The Census Bureau numbers on income and poverty in 2005, released on Aug. 29, had something for everyone going into the fall election season. Republicans could trumpet the 1.1% increase in real median



household income in 2005, the first such gain since 1999, as a sign that the economy is on the right track. Democrats could point to the decline in the real median earnings of full-time male workers, to the lowest level since 1997, as an indication that the labor market is still deteriorating. Optimists could enjoy the teensy decline in the poverty rate, from 12.7% to 12.6%, while pessimists could fret about greater income inequality.

And pro- and anti-immigrant advocates could argue over the fact that all the income gains came from foreign-born households, while the native-born were treading water.

The week's more recent statistics were mixed, too. Unemployment claims held at a low level, a good sign (commuters at Grand Central Terminal, photo). But consumers waxed gloomier than expected, and new-home sales sagged. The dismal science consensus: Slower growth ahead, but no recession.

See "Picking up the slack from housing," page 25

**Web Titans Team Up** Just when it looked like Google and eBay were headed for a battle royal, peace broke out with a major ad deal on Aug. 28. Google will provide Web search advertising on eBay's international sites. The two will also develop click-to-call ads, which let potential buyers click on a link to talk to merchants through their computers. What gives? Pragmatism. eBay needs Google's ad expertise, and Google needs Skype's 100 million Net phone users. But it's an uneasy détente: They will continue to scrap over online merchants and payment systems.

**ONLINE** See "Google and eBay's new connection," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Apple's Power Failure** Just a week after Dell announced the largest PC battery recall in history, Apple followed up Aug. 24 with the second-largest, affecting older notebooks. The culprit was a division of Sony, which said the battery may cause an internal spark that can lead to a fire. Investors yawned at the news, which won't short out Apple's earnings, but 1.7 million iBook and PowerBook owners cringed at the hassle of sending away for a replacement. On Aug. 30, Apple signaled a deepening of its ties with Google by naming the search king's CEO, Eric Schmidt, to the board.

**ONLINE** See "The Assault on Apple's battery," and "Time for an Apple/Google mash-up," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Merger, Italian-Style** Italy's banks dawdled for years instead of consolidating, shielded by regulators who shooed out European suitors. But when new Bank of Italy chief Mario Draghi said in June he would welcome cross-border deals, the game of fragmented fiefdoms was up. The move triggered a shotgun merger announced on Aug. 28 between Banca Intesa and Sanpaolo IMI, the nation's second- and third-largest, creating a powerhouse with 22% of the Italian banking market and \$83 billion in market cap. Now, No. 4, Capitalia, needs to find a bride and fast—before the barbarians storm Italy's northern gates.

**ONLINE** See "Europe's banks: Is the M&A game finally afoot?" [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Guilty Pleas** Two giants are paying big bucks to get out from under legal clouds. On Aug. 28, Prudential Financial agreed to fork over \$600 million to settle charges in a mutual fund trading scandal. It admitted to criminal wrongdoing, the first firm caught up in the investigation to do so. And on Aug. 29 drugmaker Schering-Plough said it would pay \$435 million to settle civil and criminal charges of defrauding Medicare. Its Schering Sales unit pleaded guilty to one count of conspiracy.

**BP: Another Stain?** Extending BP's string of bad news, *The Wall Street Journal* reported on Aug. 29 that regulators are looking into whether the London oil major manipulated crude-oil and unleaded-gasoline markets. The poenas in the crude probe focus on 2003-04, while the inquiry examines New York Mercantile Exchange trading in 2002, sources told the *Journal*. Regulators decline comment, and BP said the company "routinely" gets requests from authorities.

**ONLINE** See "Did BP manipulate the market?" [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**From Coke to Clorox** Can he do for laundry detergent what he did for soda? On Aug. 30, Clorox said that the executive responsible for the turnaround of Coca-Cola's North American unit, Donald Knauss, was leaving to take the top spot at the beleaguered bleachmaker. The 10-year-old Knauss will be succeeded by J. Alexander "Sandy" Douglas Jr., who has run the North American unit before.



**Kinder Morgan Says Yes** They had to sweeten the pot, but **Kinder Morgan CEO Richard Kinder**, three fellow directors, and private equity investors including **Goldman Sachs, Carlyle Group**, and **AIG** won approval on Aug. 29 for a \$14 billion LBO of the oil-and-gas distribution giant. The deal, first proposed in May, will roughly double Kinder Morgan's debt, to around \$14 billion.

**New Rules for Going Broke in China** Creditors can breathe easier since Beijing on Aug. 27 passed a long-awaited corporate bankruptcy law. It takes effect on June 1, replacing a 20-year-old relic that applied only to state-owned enterprises and mainly focused on protecting workers. Private firms and financial institutions will now be covered, and creditors will be first in line for payment, ahead of employees.

**ONLINE** See "China's new mantra: Creditors first," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Real Estate Sale By Owner** The last big refuge for the middle class in Manhattan is up for grabs. **MetLife** says it's entering offers for 11,200 apartments on the East Side. The acre complex known as **Peter Cooper Village** and **West Village** might fetch \$5 billion, *The New York Times* estimates. Renters won't be tossed out on First Avenue: About three-quarters are paying below-market prices under New York's rent-stabilization law and will continue to be protected even under new ownership.

**Drugmaker Reverse** One of the **Vioxx** rulings that whacked the drugmaker last week was overturned on Aug. 30. The judge said \$51 million in damages was excessive and ordered a new trial to determine the right amount.

## Fugitive of the Week

Where in the world is **Jacob Alexander**, a.k.a. Kobi? Sri Lanka? Israel? Parts unknown? The former CEO of **Comverse Technology** took a powder shortly before federal prosecutors charged him and two other ex-Comverse execs on Aug. 18 with securities, mail, and wire fraud for allegedly backdating stock options at the New York software company—so the unfolding options scandal now features an international manhunt. A prominent Israeli businessman who also holds U.S. citizenship, Alexander vanished not long after wiring \$57 million to an Israeli bank account. So far he has managed to evade capture by the **FBI** and **Interpol** while unleashing a swirl of rumors concerning his whereabouts. On Aug. 24, **Moshe Buller**, an Israeli private detective hired by a venture capital firm to find Alexander, claimed he'd spotted the fugitive late at night in a Sri Lankan fishing village. But some have questioned that story, and by the time it hit Israeli papers, Alexander appeared to be long gone.



JACOB ALEXANDER

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**DEALMAKING**

# THE LBO GANG STORMS THE VALLEY

High-powered private-equity players are talking frustrated techies into the idea of going private—and making billions

**BY PETER BURROWS**

**M**ICHAEL E. MARKS has long been a salesman, of sorts. As CEO of Flextronics Corp. for 13 years, he wooed execs into letting his company take over their plants and make their products. "I spent my days calling the people that run technology companies, asking them why they were still doing their own manufacturing: 'Why don't you let us make you an offer to buy your factories?'" Marks recalls. By his retirement last year, he had built Flextronics into a \$16 billion behemoth.

Now, Marks is singing another siren song for tech executives: Let me take your company private. He is one in an army of high-powered private-equity players who are stalking the Valley in search of buyout candidates. Marks has traded his cramped Flextronics cubicle for an ornate office in Menlo Park, Calif., with the legendary leveraged buyout (LBO) firm Kohlberg Kravis Roberts & Co. "I pretty much spend my days calling the same people," Marks says, "except instead of trying to get their factories, I'm trying to buy all or part of their company."

That pitch is getting a surprisingly warm reception. After a half-decade of crushing pressure to hit their quarterly numbers, stagnant or shrinking stock prices, and scrutiny on everything from offshoring to stock options accounting, many frustrated techies are ready to entertain the option of going private. They believe their companies can thrive outside the glare of public scrutiny.

Of course, an LBO can also make executives fabulously wealthy: They get a huge pop in their own shares by selling out at the typical 20%-plus LBO premium. And in most deals, top management is invited to invest alongside dealmakers in return for low-priced shares and hefty options grants. "All kinds of people are thinking about bailing," says one leading tech CEO, who asked for anonymity. "If you miss [earnings] by a penny these days, you end up getting fried on CNBC. Then there's this private-equity option, where you can make a ton of money."

## EYES WIDE OPEN

THINGS STARTED HEATING UP a year ago when data processing giant SunGard Data Systems Inc. went private in an \$11.4 billion deal, the biggest tech LBO in years.

Since then, many have followed. Last vember, for instance, Serena Software in San Mateo sold itself to private-equity firm Silver Lake Partners for \$1.3 billion. And in August, KKR and Silver I bought Royal Philips Electronics' unit for \$9.5 billion. Meanwhile, on that went private at the start of the decade such as Seagate Technology and Veri Inc., came storming back with successful initial public offerings.

That opened the eyes of many a chief to the possibilities of private equity. Today the companies that are being considered include Sun Microsystems, 1 Symantec, and a host of troubled telecom like Siemens, Nortel, and Avaya. Big tract manufacturers such as Jabil Circuit Inc. and Celestica are high on some lists. And service plays such as Electronic Systems. And since the Philips deal, chipmakers have suddenly begun running up dealmakers, say private-equity sources.

A wave of privatization would mark a sharp reversal from the classic Silicon Valley playbook. Throughout the 1980s and '90s, tech companies thrived on a high-tane combination of venture capital, options, and IPOs. Other than a few boutique firms, the LBO crowd rarely





around much. Techies were growing too quickly, consuming too much capital, and enjoying their rising share prices too much to consider loading up on debt and milking cash flow to pay it off.

But times have changed. Now the more mature tech companies are struggling to grow 10% a year. Iconic stocks such as Microsoft, Intel, EMC, and Dell have been trading sideways, or worse, for years. With cash reserves on the rise as managers trim growth-related investments, dozens of name-brand companies now pop up on dealmakers' spreadsheets as LBO candidates. In July analysts at Prudential Equity Group screened a database for buyout targets and turned up names like Hewlett-Packard Co. and Applied Materials Inc.

Private-equity firms worldwide are expected to raise up to \$280 billion this year, according to researcher Private Equity Intelligence, making megadeals suddenly seem possible. Says Prudential analyst Edward Keon: "Clearly, I'm exaggerating here, but what's the difference between a \$30 billion deal and a \$300 billion deal? It's just a few more phone calls. As more money flows into private equity, and the pressure to put it to work grows, it's possible that these deals get bigger and bigger."

Practically speaking, there are limits. Sure, no company fits the slower-growth, high-cash-flow profile better than Mi-



**MARKS** Now at KKR, the former Flextronics boss sings a new song

crosoft Corp. But it's hard to imagine financiers putting together the \$84 billion in cash that would be required to do a \$336 billion buyout, presuming buyout firms paid a 30%

premium to its stock price and put up a quarter of that in equity. Instead, industry insiders say the biggest deal possible at this point is \$50 billion—enough to make a run at chipmaker Texas Instruments Inc. or perhaps PC maker Dell.

Executives insist that what excites them, more than riches, is the chance to focus on such long-term decisions as selling off divisions or cranking up research and development, which may be needed to spark their companies but would spook Wall Street. The private-equity crowd encourages that mindset. "Most of

these companies are very good companies, and we're setting them free from the 90-day management process," says John W. Marren, a partner at private-equity firm Texas Pacific Group. "How much of CEO's day is spent worrying about the latest government investigation, or talking to some hedge fund manager about whether orders are going to be up 0.1% 1% this month?"

## PENNY-PINCHERS' WRATH

A LOT, SAYS SUNGARD's Christóbal Conde. He recalls as head of a public company he used to walk around with quarterly earnings playing like an adjugle in the back of his head. "When you run a public company, so much of your personal credibility is tied to the volatility of earnings," Conde says. Before, he could fund only 8 to 10 R&D projects a time without attracting the wrath of Wall Street penny-pinchers. Now, Conde says he has 53 different projects under way and five times the R&D budget he had while SunGard was public.

Still, going private is no panacea for all of tech's complaints. For starters, big deals are typically financed in part via high-yield bonds, which require quarterly reporting. So you trade complaints from shareholders focused on next quarter earnings for debt holders with an eye on credit ratings and cash burn.

Private owners also can be more demanding than Wall Street. Douglas

Bergeron left buyout Gores Technology Group to run Verifone after the maker of credit-card processing gear was bought from HP in 2001. That to its 2005 IPO, Verifone saw its value rise from \$50 million to \$1.5 billion in that time. But it took total management shakeout and an operational focus that Bergeron says lacking in much of the public company. "You can hide a lot of problems when you're growing at 25% a year that's no longer the case for these companies. In private, owners will stand around and let management be ineffectual."

That sounds scary more than a few tech companies are likely to their chances. ■

—With Justin Hibbs, San Mateo, Calif.

## Five Reasons **Private** Makes Sense

Leveraged buyouts are a big step back from Silicon Valley's growth culture. Here's why many tech outfits are considering them:



### BECAUSE WE CAN

Deal sizes are growing. Insiders expect to see

\$40 billion deals in the next year, even \$50 billion—enough to buy Sun Microsystems, Advanced Micro Devices, EMC, or maybe even Dell.



### WALL STREET HATES US

Since the Net bust, tech outfits have

struggled for double-digit growth, and many stocks have flatlined. But with rich cash flows and salable assets, they fit the LBO profile.



### WE HATE WALL STREET

Forget managing quarter to

quarter. Instead of the fund managers and day traders that will dump and run if a CEO misses his results by a penny, he gets owners who let him focus on the long term.



### WE'RE SICK OF THE SCRUTINY

Many executives complain of the

time and money needed to comply with Sarbanes-Oxley and deal with post-Enron public mistrust over executive pay and offshoring. Going private eases the scrutiny.



### WE GET FILTHY RICH

Typically, LBO firms pay a 20%-

plus premium, so tech execs would finally see a pop in their stock. Plus, they can get big options grants at a time when public boards are living in fear of federal regulators.



zA

# GENERAL ELECTRIC, THE IMMELT WAY

## The boss talks about his five years as CEO and what's ahead for the company

It's been a tumultuous five years for Jeffrey R. Immelt, who took over the top job at General Electric Co. shortly before September 11, 2001. Amid war, post-Enron regulation and investor boredom with blue-chip stocks, he has bought or sold businesses worth \$100 billion. He has pushed for innovation and green technologies. Has it paid off? Immelt thinks so, but investors have their doubts. GE stock (adjusted for splits and dividends) is worth less than it was the day he took over and is one-third of the highs of 2000. Immelt spoke recently with Senior Writer Michael Brady. Below are edited excerpts of their conversation.

**It walked into a storm.**

The first year was tougher than you could imagine. You had 9/11, Enron, and the recession. The way CEOs and companies were viewed changed 180 degrees in 15 minutes. I was a rookie CEO... following the most famous guy in history.

**How has life changed since you became CEO?**

One thing you get is too much service. Everybody wants to carry your bag. I will not be home in my own car tonight. I don't like driving to be particularly tough. You want to get back to normalcy.

**What's the downside of the public's lack of experience these days?**

The pendulum on regulation has swung too far and needs to come back some... My job is to play by the rules of the day.

**Chairman David Calhoun just left GE with a potential payout of \$100 million to a private media outfit [VNU]. Has your equity changed the game?**

A lot of dollars go to alternative investors now, hedge funds and private

equity—dollars that used to go to the New York Stock Exchange, GE stock, and things like that. It's a very different job from what we do. We get to see ideas come together. That's what makes GE fun in a way that the private-equity experience isn't. I remember the day when our sales in China were zero. Now they're \$6 billion. In private equity, you buy, fix, and sell. Here, you buy, invest, and build.... Most of my best friends work for GE.



**The first year was tougher than I could imagine. You had 9/11, Enron, and the recession...I was a rookie CEO following the most famous guy in history"**

**How do you get investors excited about the stock again?**

My job is to figure out how to grow and manage risk and volatility at the same time. We're in better shape than we were in 2001. GE is 65% bigger, and earnings have doubled.

**There's a lot of attention on GE and others going green. Why now?**

In 2004 we were going through our summer strategic plan, and about two-thirds of the business reviews included new products in energy efficiency, water conservation, and

environmental technologies. So we turned it into a growth campaign. Until 2004 I had never camped outside. Never.

**Do you recycle?**

I'm not sure. Maybe somebody in my house does. It's not like I'm Johnny Appleseed here. This was purely about the science of business. I don't consider myself an environmentalist. I'm a business leader who says this is an important trend.

**The nonperformer right now is NBC.**

We've developed more shows for the fall. *Studio 60* is just phenomenal—edgy, funny, and shocking. And the Tina Fey show is great. Alec Baldwin plays the thug from GE, and he's hilarious.

**What's next?**

I think about the intensification of globalization a lot, and preparing GE for that. We sell MRI scanners that cost about \$1.5 million in the U.S. Now it's about designing a scanner that can sell for \$500,000 in China. We need to do that 10 or 15 times.

**BusinessWeek online** For an extended interview with Immelt, go to [www.businessweek.com/extras](http://www.businessweek.com/extras)







## Apple's Jobs and Wal-Mart's Scott are duking it out over small screens

other studios come along, t  
So far, other large stud  
have taken a pass, especially  
ter Wal-Mart earlier this y  
threatened not to sell Disne  
*High School Musical* for a ti  
after Disney released it initi  
only on iTunes. What does W  
Mart want this time to p  
nice? Executives who have  
with Porter say it wants m  
keting help when it launches

own planned download site. And it wa  
Hollywood to trim the current \$17 wh  
sale price for DVDs. That would let V  
Mart slash its own prices to the same  
or so that Apple would charge. (The pla  
for Apple to pay a \$14 wholesale price  
new releases, say sources, although ne  
negotiations continue.) A large wholesa  
for Wal-Mart, of course, would amoun  
hundreds of millions in lost studio  
venues each year at a time when DVD s  
are slowing.

### TIRED OF TIPTOEING

WAL-MART ISN'T the only issue that's  
ing some studios pause. Several are  
cerned about Apple's rules for u  
iTunes, which let users watch a film o  
to five different devices. And others w  
about letting Jobs set a download p  
they can't change, as he has done in m  
Still, studios have embraced the di  
concept and accept some "burning  
movies to DVDs. In addition to Apple  
studios are negotiating potential d  
load deals with Amazon.com, AT&T,  
cable giant Comcast.

No doubt Steve Jobs knows how to  
tiny digital media niches into a mainst  
phenomenon. That's what he did in  
music biz. But his patience for all thi  
toeing is wearing thin. Jobs rec  
hopped aboard his corporate jet for a  
politicking of his own in Hollywood.  
insiders say he called Scott to expres  
concern of a vendor who sells tons of  
and Macs through Wal-Mart stores.  
would not comment for this story.

would any studios.  
Mart acknowledged  
it's talking with st  
about starting its  
download service  
disputed that it is  
suading studios  
conducting bu  
with other provi  
according to Wal  
spokeswoman Jo  
Stewart. ■

—With Peter Burr  
San Mateo

### TINSELTOWN

## THE EMPIRE STRIKES BACK

Wal-Mart sees a threat from iTunes downloads

BY RONALD GROVER

**T**HE GUY FROM BEN-  
tonville, Ark., surely isn't  
on any of Hollywood's  
leading man lists. A 23-  
year Wal-Mart Stores Inc.  
veteran, David Porter is the  
person at the retail giant  
who orders DVDs and slashes prices to  
move them. But this summer, Porter has  
been one of Hollywood's hottest acts, tak-  
ing meetings with top studio brass like a  
producer with a hot script. His pitch: Wal-  
Mart isn't happy.

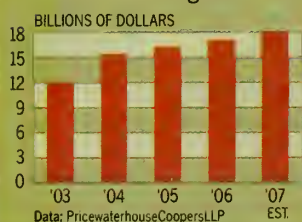
That prospect tends to send shivers  
through Hollywood's Gucci-toed corner  
offices. As the largest seller of DVDs, Wal-  
Mart accounts for roughly 40% of the \$17  
billion in DVDs that will be sold this year,  
a financial lifeline to big-spending stu-

dios. But now Wal-Mart's video business  
faces a potential threat by Steve Jobs and  
Apple Computer Inc., which in mid-Sep-  
tember, sources tell *BusinessWeek*, plans to  
announce it will start offering movie  
downloads from its iTunes store. The no-  
tion of kids running around with full-  
length movies on new, wider-screen  
iPods that Apple is expected to unveil as  
well is causing grief in Bentonville, ac-  
cording to Hollywood executives. The  
\$312 billion a year retailer, they say, wants  
concessions that could include lower  
DVD wholesale prices.

With Wal-Mart CEO H. Lee Scott as-  
signing his point man Porter to roam the  
halls of major studios, skittish executives  
have for months delayed giving Jobs the  
rights to distribute their movies through  
his new service. The price Apple hopes to  
charge, now set at \$14.99 for new releases  
and \$9.99 for older movies, has risen from  
Jobs's initial plan to offer new flicks for  
\$9.99, say industry insiders. And so far, Ap-  
ple only has one studio signed on: Walt Disney  
Co., where Jobs is the  
largest shareholder fol-  
lowing the entertain-  
ment giant's purchase  
of his Pixar Animation  
Studios. News Corp.'s  
Fox Entertainment  
Group may join in later,  
as might independent  
Lions Gate Entertain-  
ment, say Hollywood  
sources, but only if

### SLOW MOTION

Growth in retail sales of  
DVDs is slacking off







The endless hustle and stress of the modern world - many people accept it as part of the game. But it doesn't need to be that way. When technology helps life run more smoothly, the modern world can be unbelievably peaceful.

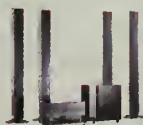
Meet LG Electronics and enjoy it all:  
Life's pleasures. Life's rewards. **Life's Good.**



LG chocolate, the slim and cool phone, lets you enjoy songs and videos.



LG HD Plasma TV lets you record your favorite shows and stop them live.



LG Flat Panel Home Theater lets you enjoy superior sound and picture quality.



LG Steam Washer's innovative technology refreshes your day.



[www.lge.com](http://www.lge.com)





## COMEBACKS

# SHRIMP BURGERS TO THE RESCUE

CEO Harada has halted falling sales at McDonald's Japan. Now for some profits

BY IAN ROWLEY

**F**OR MOST OF THE PAST TWO years, Eikoh Harada's jump from iMac to the Big Mac has looked like a pretty bad move. In March, 2004, Harada quit as president of Apple Computer Inc.'s Japanese business and took over as chief executive of McDonald's there. Although he had earned praise for turning around Apple's operations, many doubted he had what it took to combat slumping sales and profits in McDonald's second-biggest market after the U.S.

Until recently, it looked as if the doubters might be right. True, under Harada annual sales have risen 8.5%, to \$2.8 billion. But last year, net profits slumped 98%, to \$515,000. The weak earnings stemmed partly from restructuring costs, but a big factor has been a strategy of pricing Big Macs, fries, and other items at just 100 yen (85¢). "The cheap burgers attract customers but don't contribute to earnings," says Yasuhiro Matsumoto, an analyst at Shinsei Securities Co. in Tokyo.

These days, though, it appears Harada may be on to something. McDonald's Japan has outperformed a sluggish market for fast food and posted increases in same-store sales of as much as 11.6% every month since February. Perhaps more important, customers are spending more. On Aug. 2, the company posted a 650% climb in operating profits to \$10.7 million for the first six months of year, prompting Harada to raise his full-year projection for pretax profits by 20%. That's helping the fortunes of McDonald's Corp., which owns half of Tokyo-listed McDonald's Holdings Co. (Japan). Announcing second-quarter sales results on July 17, McDonald's CEO Jim Skinner cited "strong performance in Japan and Australia."

Harada's efforts have been helped by

**WELL SERVED** To compete, more McDonald's outlets will stay open 24/7

new sandwich better tailored Japanese taste. One hit: the 1

Filet-O, a shrimp burger that generated sales of 10 million in the first three months after its launch last October. New salad plates introduced in May, called Salad Macs, are proving just as successful, despite prices around \$5

## FANCIER MENUS

**STILL, REBUILDING** the brand will take more than just a few hits, however. When McDonald's Japan listed in Tokyo in 2001, the company aimed to have 10,000 restaurants by 2010. Today, there are 3,600. At 16.65, the stock trades at less than half its initial public offering price, and, so far, hasn't really budged despite the rising sales. Operating margin, which regularly topped 8% a decade ago, remains at about 2% today.

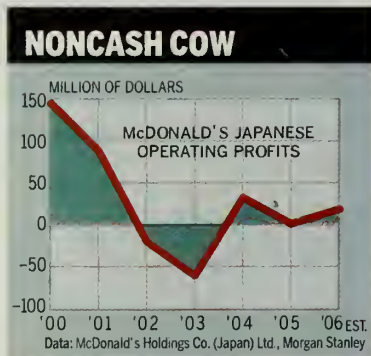
Today young Japanese are happy to pony up for a Caramel Frappuccino from Starbucks or a bowl of noodles at a mom-and-pop eatery. "I don't go [to McDonald's] that often," says Takeshi Mizoe, a video game developer in Tokyo. "There are so many other good restaurants." There are also 30,000 convenience stores selling everything from sausage sushi. They account for a third of Japan's \$62 billion fast-food market. To hit his target, Harada says McDonald's will keep restaurants open 24 hours a day. Core concerns are demographics and the bounding economy. With fewer children being born in Japan, the traditional customer base is shrinking. And as deflation tapers off, cheap McDonald's grub is tempting. "With the macroeconomic

environment picking up, the quality of the food becomes more important and people are less about price," says Yukimi Oda, an analyst at Morgan Stanley in Tokyo.

Harada is keen to move further up the market. "We have to compete with our customers," he says. McDonald's now offers wireless Internet

service at 2,660 restaurants, increasing traffic as salarymen surf while they wait. Harada is even considering a new fight with fancier menus and interiors, though he's sparse on the details. "Of course, our Golden Arches will stay."

—With Hiroko Tashiro in



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## TAX BATTLES

# BIG TOBACCO'S SHOWDOWN IN THE WEST

Barring a PR miracle, California is about to add \$2.60 in tax per pack of smokes

BY NANETTE BYRNES

**I**N CALIFORNIA, ADS FOR THE Nov. 7 elections normally wouldn't make it to TV before Labor Day. But for Proposition 86, tobacco companies got a big head start. The measure would impose the largest one-time cigarette tax hike ever—adding \$2.60 to a pack of smokes, on top of an existing 87¢ excise tax, bringing the average price per pack to \$6.55. So, by early August, viewers were blitzed with a \$7 million ad campaign criticizing the hospital corporations that helped write the proposal. By itself, Altria Group Inc.'s Philip Morris, maker of No. 1 brand Marlboro, has put more than \$17 million toward fighting the measure.

A loss on Prop 86 would add to a series of statehouse setbacks for Big Tobacco (table). Of late, cigarette makers have won

some major legal battles, including drastically reducing the Justice Dept.'s once-mammoth suit against the industry. But tobacco companies may yet lose the war. Price increases are a singularly effective smoking deterrent, especially among the young. And since 2002, according to the Campaign for Tobacco-Free Kids, 42 states have raised smoking taxes, as have Washington, D.C., Puerto Rico, and Guam.

That's despite the states' generally good financial shape, and despite the tobacco industry's famously vigorous lobbying efforts. A \$1 hike approved in Texas in May was fought by 52 separate lobbyists paid for by industry (15 of them by Philip Morris alone), according to Texans for Public Justice, a state lobbying watchdog. When the mostly nonsmoking general public votes, Big Tobacco has proved a particularly easy mark. Citigroup ana-

lyst Bonnie Herzog expects California measure to pass handily, constraining cigarette makers' ability to raise prices, they have the past two years.

## "IRRESPONSIBLE SPENDING"

CALIFORNIA IS HOME to 9% of all U.S. smokers, and a successful Prop 86 would certainly dent tobacco companies' bottom lines. An analysis by the Tobacco Control Section of the California Health Services Dept. expects that it could cut cigarette sales by 312 million packs a year. Let's estimate, conservatively, that Philip Morris makes a profit of 20¢ per pack. Given 51% market share, that's a \$32 million loss. Plus, the Tobacco Control Section predicts the smoking rate among high school students will drop from 13.2% in 2004 to 7.6%.

Cigarette makers argue that Proposition 86 doesn't require all tax money to be spent on programs to help smokers quit or treating smokers' illnesses, and that the measure needlessly includes an antitrust exemption for hospital companies. "It's irresponsible spending of the public's money," says Fredrick McConnell, a spokesman for R.J. Reynolds Tobacco Co., maker of Camel cigarettes, which is spending \$5 million this year to fight tax hikes and smoking bans in four states.

Prop 86 backers promise \$2 billion in new tax revenue and a \$16.5 billion long-term decline in health-care costs. But McConnell argues that untaxed counterfeits and buying from other states will limit sales, ultimately undermining tobacco revenue and shrinking the \$1 billion California now gets yearly from the company's 1998 Master Settlement Agreement.

Proponents—including the American Cancer Society, American Lung Assn., and others—argue that every state that has increased the tax has come out ahead in the long run. But to them, the key issue is the smoking rate. "If you raise the price 10%, it should reduce overall consumption by about 4% and reduce youth smoking 6% or 7%," says Eric Lindblom, director for policy research at the Campaign for Tobacco-Free Kids. Ultimately, they say, that's what gives the industry the jitter.

## The Latest Attack on Tobacco

Just as the danger of litigation is decreasing, excise taxes are increasing

### CALIFORNIA

This November voters will decide on a proposition to raise excise taxes \$2.60 per pack

### TEXAS

\$1.00 per pack increase signed into law in May despite a heavy lobbying campaign by industry

### MISSOURI

There is a court battle to get a measure that would increase taxes by 80¢ per pack on the November ballot

### NEW JERSEY

Raised taxes 17.5¢ per pack, the fourth increase in five years, to \$2.57 a pack, the highest in the nation

### MARYLAND

Several candidates running for office and some in power are pushing for a \$1 per pack increase

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JOHNNY C. WHITE  
CIO

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# COMMENTARY

BY DAVID HENRY

## How the Options Mess Got So Ugly—and Expensive

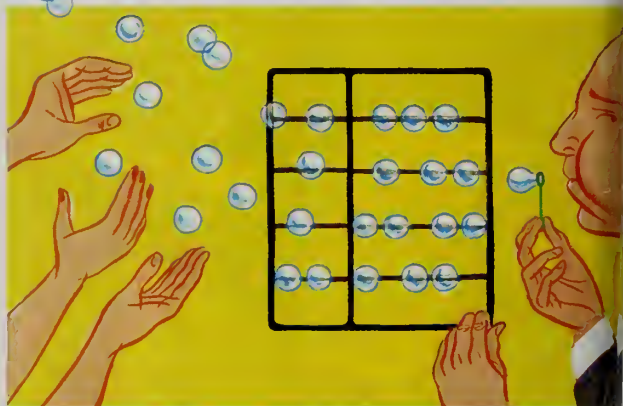
As grants soared in the 1990s, so did the temptation to cheat when issuing them

SIR WALTER SCOTT HAD IT right when he wrote “Oh, what a tangled web we weave, when first we practice to deceive!” More than 121 companies are undergoing investigations to untangle right from wrong in the mess left by widespread grants of stock options to employees in the late 1990s. It seems to get only more complicated by the day. And it all could have been prevented 12 years ago.

A flood of option grants, and apparent backdating, grew out of companies’ misleading arguments in 1994 that options are not a cost. Corporate chiefs persuaded Congress to go along with that pretense and force the Financial Accounting Standards Board, or FASB, to retreat from its plan to make them count options as expenses. Over the next 11 years companies in the Standard & Poor’s 500-stock index dismissed \$246 billion in options compensation, overstating earnings by 7%, according to *The Analyst’s Accounting Observer*.

Now the consequences of the free-money facade have gone beyond earnings exaggerations to fraud investigations. The Securities & Exchange Commission has launched 74 inquiries into possibly fraudulent backdating of grants, says researcher Glass, Lewis & Co. Prosecutors have started 49 criminal probes. “It is unprecedented to have so many major corporations under investigation at one time,” says Matthew J. Jacobs, a former federal prosecutor now heading a white-collar defense team in Silicon Valley at McDermott Will & Emery. Apple Computer, Home Depot, and Caremark Rx, each of which opposed expensing in ’94, are under investigation.

Some probes will likely find no crimes, just sloppy books. But all are costly. Companies must pay accountants and lawyers to study documents and see if options carried true dates. “On these types of investigations, I don’t think you can blow your nose for less than \$1 million,” says Lynn E. Turner, managing director of research at Glass Lewis. Software provider Mercury Interactive Corp. has spent at least \$70 million.

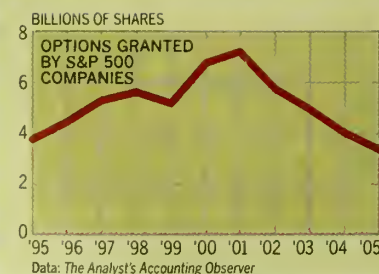


The year 1994 triggered the disaster. Congress, by agreeing to stop FASB, essentially blessed the practice of paying employees with options. Grants soared, doubling by 2001 for S&P 500 companies overall. Many tech outfits cranked up the printing presses even faster, paying executives and enticing new recruits with options instead of with earnings-reduced cash. As the grants increased, so did temptation, since the gain from cheating went up with each additional option, says Fabrizio Ferri, an assistant professor at Harvard Business School. Winning in Washington also sent a message to company directors, controllers, and auditors that they needn’t monitor options the way they do cash. “It put the gatekeepers in a mindset of not challenging anyone,” says Turner, a former chief accountant. With little incentive to make sure grants were correct, it’s no wonder many investigations seem to be taking forever.

Although FASB now requires expensing, resistance ended

Last month the University of California Berkeley’s Haas School of Business published a paper arguing for repeal of expensing. It was signed by 30 experts, including three Nobel prizewinners in economics. The paper contends that options are instruments for sharing stockholder gains, not company expenses. Whatever the merits of the argument, it won’t undo the damage from abuse of options. Says Jack T. Ciesla, publisher of *The Analyst’s Accounting Observer*: “They ought to just give it a pass. With these things, people can’t see their own worst impulses in check.”

### OPTIONS’ RISE AND FALL



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KOREA

# ONLINE GAMING: KOREA'S GOTTA HAVE IT

The number of addicts is growing. Will the problem spread to other countries?

BY MOON IHLWAN

**F**AMOUS STEED WAS A LEGEND. For more than two years, the magician had used fire, ice, and lightning to battle dragons and monsters on the fantasy continent of Hellmarsh, eventually climbing

162 levels to become one of the top five players among hundreds of thousands of rivals in the Korean online game A3. Famous Steed's real life, on the other hand, didn't look quite so glamorous. The magician's alter ego, S.H. Kang, had shuttered his money-losing cosmetics store in 2001 and plunged nearly full-time into the medieval world of A3, spending his days and many nights at the local "PC Bang," or online gaming parlor. "Back then, I played at least 24 hours before I went home to crash. I didn't know how much I slept, but when I woke up I was back at the PC Bang to get monsters," says Kang, now 35. "Online games are as addictive as gambling." Even today, though Kang has a full-time job, he says he feels the pull and spends several hours every weekend playing various games.

Kang is one of more than a half-million Koreans suffering from a malady that was unheard of a decade ago: an unhealthy obsession with online games. A government-sponsored survey last year showed that some 546,000 people—2.4% of Koreans aged 9 to 39—need counseling for Internet addiction, and some experts say it's a bigger concern than alcohol, gambling, or drugs. "On-



line gaming addiction has become a national problem," says Kim Hyun Soo, a psychiatrist who heads the Net Addiction Treatment Center in Seoul, which has helped more than 1,000 game addicts in the past four years.

The problem can even be fatal. Some players get so obsessed with winning experience points or digital doodads such as magic swords and power-boosting necklaces that they skip school, quit jobs, and play nonstop for days on end. Last year alone, at least seven people died from deep vein thrombosis, heart failure, or exhaustion while playing online games. Another committed suicide after being denied access to a game because he had cheated. "Loss of self-

control is the main problem," says Jan Woo Min, a counselor at the state-backed Center for Internet Addiction Prevention & Counseling.

## A CALL FOR REGULATION

THE PROBLEM MAY simply be the cost. Korea's headlong campaign to wire the country. After all, more than three-quarters of households enjoy ultrafast connections to the Net—which helped online game developers rack up sales of \$1.5 billion last year, almost half of the worldwide online game market.

The rest of the world may not be far behind Korea in this dangerous trend. Global sales of online games are expected nearly quadruple, to \$13 billion, by 2006, research firm DFC Intelligence predicts. In June, a gamer in Shanghai was sentenced to life in prison after fatally stabbing competitor who borrowed and then sold his virtual "dragon saber." In Amsterdam,

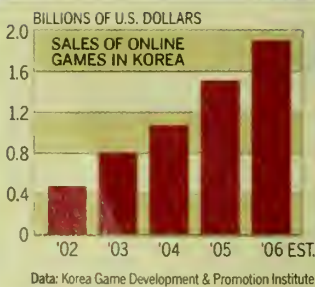
the Smith & Jones Center is home to Europe's first internet counseling program for people hooked on online games, offering a 12-step program similar to Alcoholics Anonymous.

In Korea, the government is trying to combat the problem. The Information & Communications Ministry began carrying out an annual survey of game addiction in 2002, and has set up counseling centers in eight cities to help addicts. Game companies such as Seoul-based NCsoft Co. also spend hundreds of thousands of dollars a year each to help finance some private counseling centers. "We don't believe there's concrete evidence that online games are more addictive than other entertainment, but we support educational campaigns to make people aware of potentially harmful effects," says NC spokesman Kim Joo Young.

Some say such measures are not enough. Lee Hyung Cho, a research fellow at the nonprofit Family Health & Welfare Center in Seoul, says the authorities must enact tougher regulations, including limiting adolescents' access to online games, requiring schools to teach classes on the effects of excessive play, and implementing regulations giving players fewer points if they spend more than a few hours at a stretch in front of their screens. "Games offer an escape from everyday stresses and worries," says Lee. "Those who get used to such an escape tend to look for a similar escape through drugs or alcohol later." ■

—With Steve Jacobs in Amsterdam

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# While you were away...

...You may have missed:

BY HARRY MAURER



## Ford in a Ditch

Saddled with unpopular trucks and SUVs, the carmaker said it will cut fourth-quarter production by 20%—and it may be hunting for a partner.



## Corner Office

Indra Nooyi (above) was named CEO of PepsiCo, and Pfizer named Jeffrey Kindler to replace Henry McKinnell Jr.

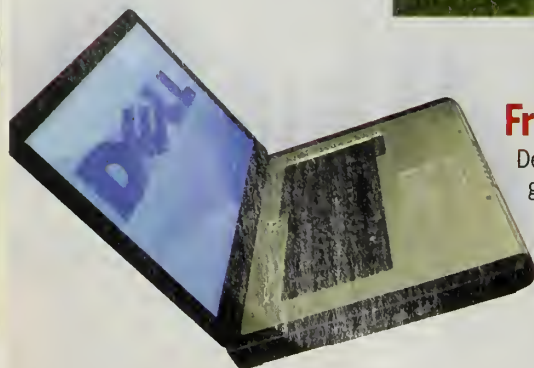
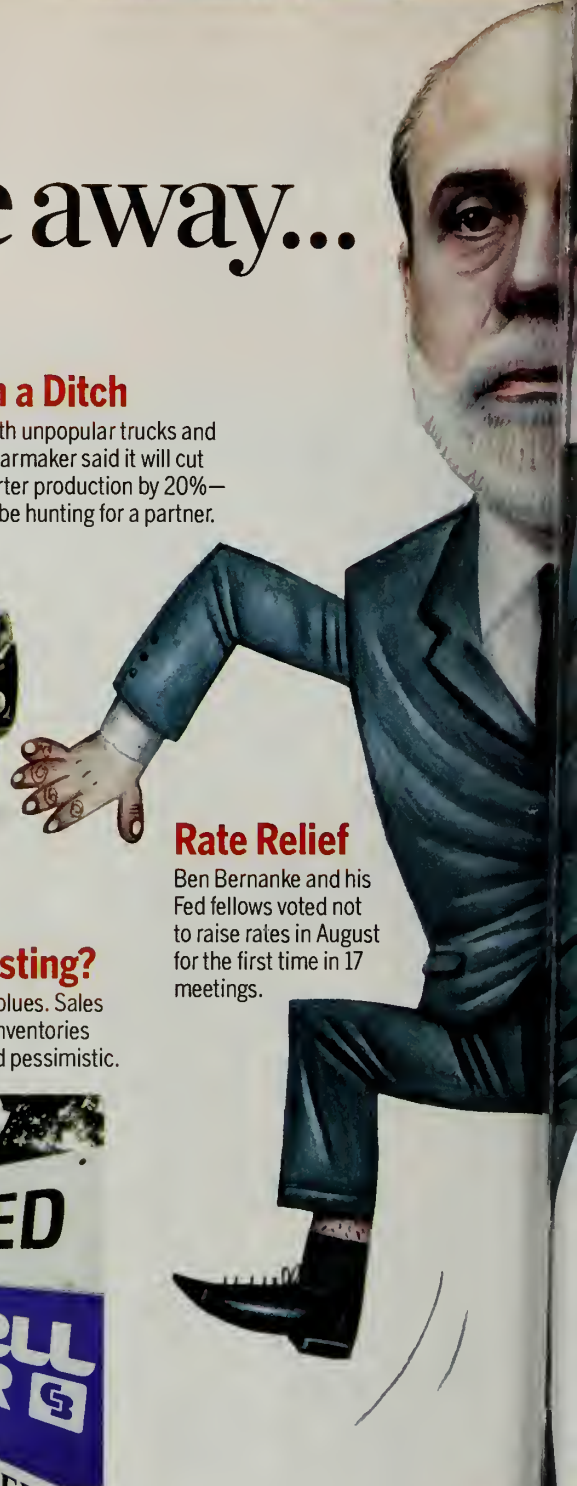
## The Sound of a Bubble Bursting?

August data left no doubt that housing has the blues. Sales of new and previously owned homes tumbled, inventories got fatter, and luxury builder Toll Brothers waxed pessimistic.



## Rate Relief

Ben Bernanke and his Fed fellows voted not to raise rates in August for the first time in 17 meetings.



## Free Fall

Dell's dismal summer got even worse, as second-quarter profits sank by 51% and the SEC starting poking around.



## Cleared

Onetime investment banker extraordinaire Frank Quattrone cut a deal with the feds and may be back in business before long.

CREDITS: (CLOCKWISE FROM TOP LEFT) PAUL SANCYA/AP PHOTO (FORD); GLYNIS SWEENEY (BERNANKE); NAJLAH FEANNY/CORBIS (FOR-SALE SIGN); RICK MAIMAN/POLARIS (QUATTRONE); HARRY CABLUCK/AP PHOTO (DELL); PEPSICO INC./BLOOMBERG NEWS (NOOYI)



# And now that you're back...

...You'll want to keep an eye on:

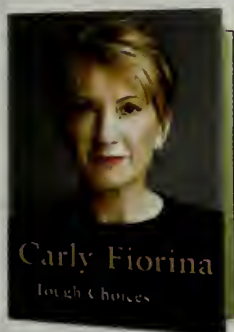
## Rate Anxiety

The Fed meets on Sept. 20, and while minutes from the August meeting make clear that the governors held their fire with some ambivalence, weak housing numbers have most observers betting that Ben's crew will sit tight at 5.25%.



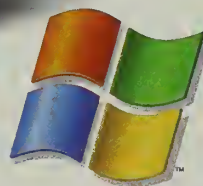
## Contentious Congress

With midterm elections looming and incumbents trembling in their loafers, Capitol Hill will grapple with issues that have stumped it so far: immigration, the minimum wage, and the estate tax.



## Carly's Tale

Ousted HP boss Carly Fiorina's book, due in early October, marks a new stage in her rebranding campaign.



## Long Wait

Microsoft says consumers will really, definitely, finally get their hands on its new operating system, Vista, early next year.

## Star Power

Can Katie Couric, who takes over as CBS *Evening News* anchor on Sept. 5, restore the show's shine after years in the cellar?



## Flicks to Go

Industry chatter says Apple will soon announce a movie-capable iPod, upsetting big DVD retailers such as Wal-Mart and further roiling Hollywood's business model.



## Day in Court

Former NYSE chief Dick Grasso goes to trial in October to face a lawsuit brought by Eliot Spitzer saying his pay package was illegal.



# Attention, Shoplifters

With \$30 billion in theft, there's a revolution in surveillance systems

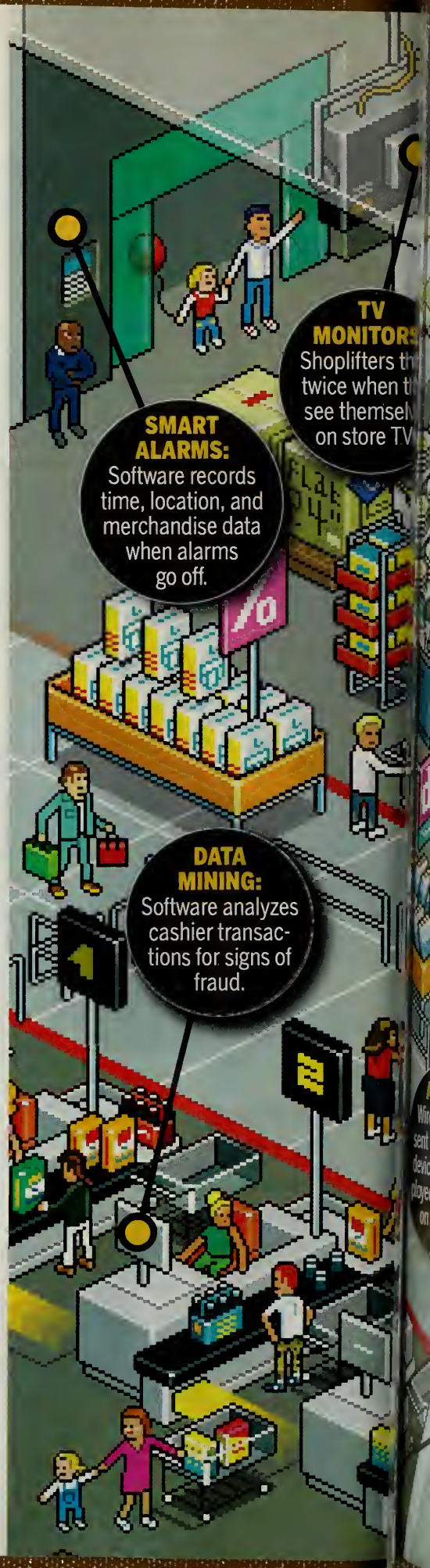
BY ELIZABETH WOYKE

**T**HERE ARE 6 MILLION VIDEO CAMERAS mounted in stores across the U.S., according to market researcher J.P. Freeman Co. Their unblinking eyes are everywhere, watching exits and peering down aisles. You already knew that. But you probably had no idea how smart some of these cameras are getting.

Some Macy's, CVS, and Babies 'R' Us stores have installed a system called the Video Investigator, whose advanced surveillance software can compare a shopper's movements between video images and recognize unusual activity. Remove 10 items from a shelf at once, for instance, or open a case that's normally kept closed and locked, and the system alerts guards sitting in a back room—or pacing the sales floor—with a chime or flashing screen. The system can predict where a shoplifter is likely to hide (at the ends of aisles, behind floor displays). A search function spots sudden movement that might indicate a large spill, prompting workers to clean up before it leads to a slip-and-fall accident and a costly lawsuit. And if someone opens a back door at 2 a.m., the system will record who sneaked in and link it with snapshots of the previous and next persons to use the door. Alerts, complete with images, can be sent to handheld devices, keeping retailers informed 24/7, says Jumbi Edulbehram, vice-president for strategic marketing at IntelliVid Corp., a Cambridge (Mass.) firm that makes the Video Investigator system.

Store managers these days need all the high-tech help they can get. Increasingly, they're under assault from organized gangs of professional shoplifters. These skilled thieves walk off with huge amounts of selected items (table, page 50) and resell them at discounts. The pros are driving up losses dramatically, to \$855 per shoplifting incident last year, from \$265 in 2003, according to a survey by the University of Florida's Center for Studies in Criminology and Law. All told, stores

Illustration by eBoy







**VIDEO:**  
Intelligent video software can detect when a large number of products is moved.

To combat theft, store surveillance systems are getting smaller, smarter, and more pervasive. Here's a look at what a hypothetical, well-equipped store might be using to watch shoppers and employees.

**RFID:**  
Radio frequency identification tags can track items like designer jeans.

**SMART CARTS:**  
Sensors can tell cart wheels to lock at the store exit.

**ALERTS:**  
Wireless alerts sent to handheld devices help employees stop theft on the floor.

**CHECK-OUT LANE:**  
Visual pattern-recognition software spots items cashiers can't see.

**DOOR ALARMS:**  
Retailers can now conceal their alarm systems under the floor.

GATE KEEPER



lost \$30 billion to shoplifting and employee theft in 2005.

To fight back, store chains are embedding smarter devices everywhere, from checkout stands to shelves to places you wouldn't even think of (and can't see). At the same time, more of these systems are talking to each other, sharing data about shoppers and employees alike.

## INVISIBLE DETECTIVES

EVEN THE LOWLY SHOPPING cart has been recruited in the war on retail crime. A surprisingly common—and simple—scam is the “push out,” in which thieves load up carts and just dash out of the store. The solution: Gatekeeper Systems Inc., in Irvine, Calif., invented an electric-fence technology for carts. The system, called GS2, uses radio frequency identification (RFID) chips, which are embedded in cart wheels, and antennas around the periphery of the store that broadcast signals to the chips. When a cart approaches the store boundary, its wheels lock up. They can be unlocked only by an employee who activates a remote-control device. “[Thieves] can't push the cart,” says Brett Osterfeld, Gatekeeper's vice-president for sales and marketing. “They'd have to pick it up and walk with it.” Target Corp. and several smaller chains have signed on.

Those handy rungs underneath the cart are great for hauling bulky items like diapers, pet food, and beer. The problem for retailers is that shoppers often “forget” to pay for the goods. The answer? Seven grocery chains, including Pathmark Stores and Giant Eagle, recently began testing LaneHawk, a system by Evolution Robotics Retail Inc. that uses visual pattern recognition to spot hidden packages. Cameras mounted in cashier stands about six inches off the ground scrutinize the bottom racks of passing carts. If an item matches an image in a database, the system computes the price of the product and adds it to the customer's bill. “It's like biometrics for packages,” says Alec Hudnut, CEO of Evolution Robotics Retail.

Many criminals aren't stupid, of course, so the name of the game for surveillance experts is making their wares all but invisible. Some of the most powerful sensor systems are being embedded right under your nose. Take those beige plastic discs that retailers snap onto clothes and accessories, called electronic article surveillance (EAS) tags. Now they're being made as small, and nearly as thin, as a toothpick. DVD manufacturers stick disposable versions on product packages before shipping to retailers. J. Crew Group Inc. sews the devices

right into clothing labels, telling shoppers to remove deactivated units before washing.

Soon stores may replace EAS tags altogether with RFID tags that offer a more precise and inconspicuous way of tracking items on a sales floor. The tags, which come in different shapes, much smaller than postage stamps, communicate with a handheld device, telling workers the exact location of a given item. Retailers like Wal-Mart and Target are big advocates of RFID technology, but for now use them mostly to monitor inventory.

Cost is one reason retailers are holding back: Tags run from 7¢ to 20¢ apiece, based on quantity; many are waiting for a tag before investing in the technology. “The tags would have been a lot cheaper...to put them on a bottle of water or pack

gum and add value rather than cost,” explains Sirri Langford, Wal-Mart's manager of RFID strategy.

Still, a few chains, including Best Buy Co. and Target Corp., are testing RFID's ability to monitor oft-stolen items like DVDs, jewelry, and apparel. Those chains have experimented with TrueVUE, a system by VUE Technology that uses antennas placed under a shelf's laminated surface to communicate with RFID tags on merchandise. Store employees could also use RFID-reading wands on racks of clothes to see which items have moved. “The program wakes up the tags, which send back their serial numbers, in effect saying, ‘I'm here,’” explains VUE CEO Robert Locke. EAS tags activate when

approach a store exit. RFID-equipped shelves can notify security the minute a large number of items move. No part of a store checks out more data than cash registers. This is also where employee theft is most likely to pop up. New types of transaction monitoring software pull information from registers in a central database and look for unusual patterns. An excessively manually entered credit-card number could be a sign that employees are stealing customers' information. Returns of the same type of sweater 10 times in a row at one register, for instance, could indicate that an employee is processing fake returns.

friend or being conned into making fraudulent returns. Retailers decide what to track and how often, and set parameters for alerts. Often the feedback points to problems other than dishonesty: might be a hardware issue or a sign that an employee needs training,” says Cheryl Blake, a vice-president at Aspect Loss Prevention, which works with Children's Place Retail Stores Inc. and Ross Stores Inc. “Whatever it is, the transactions will stick and tip off management to investigate.”

Collecting tons of information only helps, though, if y





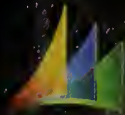
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able to sift through it and figure out what it's telling you. Already, U.S. retailers record an estimated 1,000 years of video every day, according to IntelliVid. "Rather than have someone watch and review TV for hours on end, retailers are utilizing intelligence behind the video screen," says Joe LaRocca, vice-president for loss prevention at the National Retail Federation trade group. That's why stores also are investing in technologies that can communicate with each other. RFID systems, for instance, can cue up video cameras to check out an aisle where they have detected suspicious activity, catching suspects on tape before they get out of the store. "Retailers can pull data from all these systems, look at them together and connect the dots," says Rob Garf, a research director at AMR Research.

The newest retail data-mining programs also sync up with video to permit a more comprehensive look at activity at cash registers. With the press of a button, managers can highlight irregular register transactions on their computers and pull up corresponding video. This could enable them to catch cashiers who cut deals for their friends or pocket cash refunds themselves. It could also curtail fraudulent returns by tracking the route customers take to the customer service desk—do they head straight there or meander through the store, picking up their "return" merchandise along the way?

## MUM'S THE WORD

DESPITE THIS REVOLUTION IN RETAIL tech, you won't find many stores bragging about their new security tools. No one wants to tip off shoplifters or advertise that they suspect their customers. That's why so much of the technology is hidden in

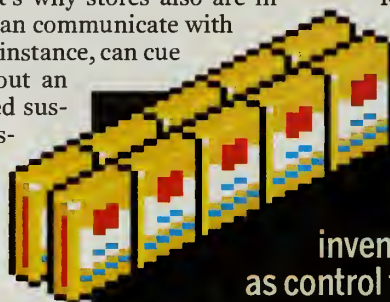
the first place. But another reason stores don't talk much about surveillance is that they know it sparks concerns about privacy. Consumer groups and legislators have opposed the spread of RFID and video surveillance for just that reason. "Item-level RFID creates privacy and security problems that are unacceptable, even for anti-theft purposes," says Katherine Albrecht, founder and director of Consumer

Against Supermarket Privacy Invasion and Numbering Retailers contend that such measures are justified because

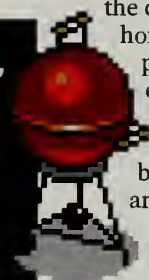
the cost of theft gets passed on to honest shoppers. Many also point out that these programs do double duty by collecting data on store traffic and out-of-stock items that can be used to fine-tune inventory and staffing. "The bottom line is, loss prevention technology improves the customer experience," says Ed Deyle, vice-president for loss prevention at CVS.

If every retail chain is not yet sold

the benefits of relying so much on chips and software to patrol store aisles, experts still believe the industry will keep moving toward ever-smarter, ever-more-networked tracking systems. A number of video cameras installed in stores is expected to grow 20% over the next year, according to J.P. Freeman. "It won't be long before retailers link their store data to crime reports and statistical analysis to predict losses...and deploy the right technology and people to stop them," says LaRocca of the National Retail Federation. Already, tech startups are working on even more promising—or intimidating—systems to track customers through the entire shopping process. There's even talk of stores installing facial recognition programs and license plate readers to catch repeat offenders. You're not likely to notice much of a difference at your favorite shopping haunts. But make no mistake: they're noticing you. ■

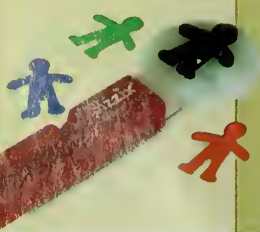


RFID chips, which monitor inventory as well as control theft, will likely replace those clunky EAS tags as soon as they hit the right cost per unit



## The Five-Finger Discount

Shoplifting has gone pro with the growth of organized theft rings. Some items they target might seem odd but are singled out for their high resale value. Some retail sectors suffer more than others:

| TYPE OF STORE             | Home Center                                                                                        | Crafts/Hobbies                                                                                                                    | Supermarkets                                                                                          | Drug/Pharmacy                                                                                                                                   | Apparel                                                                                                                               |
|---------------------------|----------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------|
| THEFT AS PERCENT OF SALES | 3.2                                                                                                | 2.6                                                                                                                               | 2.4                                                                                                   | 2.2                                                                                                                                             | 1.6                                                                                                                                   |
| "HOT" ITEMS               | Power tools<br> | Scrapbook accessories, particularly Sizzix<br> | Infant formula<br> | Dietary supplements, razor blades, hair-growth products<br> | Designer jeans, particularly Levi's and Polo<br> |

Data: National Retail Federation, 2005 National Retail Security Survey

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# A Net Pioneer's Wireless Wager

Earthlink's Sky Dayton is counting on two startups to give him his first big hit in a decade

**BY RONALD GROVER**

IT'S NEARLY FIVE IN THE AFTERNOON at the sparsely furnished seventh floor offices of Helio, a Westwood (Calif.) startup selling hip, youth-oriented cell phones that link to the MySpace.com social networking Web site. As twentysomethings in jeans and T-shirts race around the buzzing office, Internet mogul Sky Dayton is planted in front of a stand-up desk, his one concession to an achy back caused by too much snowboarding. He's checking out some critical performance data. Helio's latest sales figures? Nah. Dayton's attention is riveted to a program that lets him know when the surf is up near his Santa Monica (Calif.) home, which, he's pleased to report, is the case today. "I'm outta here soon," he says.

Riding the wave has always been Day-

ton's forte. A onetime coffeehouse owner, he became a millionaire at 26 after launching Earthlink Inc., an early and still active Internet service provider, then taking it public in 1997. Turbulence back then was when he got carded as he ordered a beer in Boston at the initial public offering road show that year. But wipeouts followed, too: ECompanies, the incubator he started in 1999 with former Walt Disney Co. Internet honcho Jake Winebaum, became a symbol for dot-com busts after launching duds such as eParties.com and Icebox Inc.

Now 35 with three kids, the guy who once took meetings in sandals is back with a new mantra:

**TOUGH SELL** Helio phones, such as the stylish Hero, cost \$200-plus



**GRAB 'EM QUICK** With Boingo and Helio, Dayton is targeting folks on the go

wireless. Dayton heads two companies that are making his risk bids to lessen the radio waves. As chairman of ECompanies venture, Boingo Wireless intends to build the nation's largest operator of Wi-Fi hotspots, linking travelers at airports and hotels to the Internet. Dayton is also CEO of Helio, a telephone operator he has imported from South Korea. Helio, which was launched in May, targets the under-30 crowd with superslick phones that surf the Web. They give users the ability to buy games and videos and share them with friends, including uploading them to a MySpace page.

The big idea behind both ventures is to use wireless technologies to connect folks who are constantly on the go, whether they're clubbing or jet-hopping. These are no seat-of-the-pants ventures, like Dayton's credit card-funded Earthlink launch. His well-heeled Boingo investors include Sprint PCS and Mitsui & Co. Five years ago, Boingo is nabbing hotspot deals, such as one in May to buy the operator of wireless services in 12 airports that include LAX and LaGuardia in New York. Meanwhile, Helio's co-owners, Earthlink and South Korean communications giant SK Telecom, have agreed to pump \$440 million into its launch.

Both ventures have ties to Earthlink, where Dayton is still a major shareholder and board member with the clout that comes with being its original visionary. With its dial-up subscription business dwindling, Earthlink is going wireless. It has projects under way or planned to provide Wi-Fi services to cities such as New Orleans, San Francisco, and Anaheim, Calif. Earthlink pays a small amount each year to license Boingo software for its existing wireless subscribers, and, down the road, Dayton sees a future where Earthlink might link with Earthlink's wireless services to provide data downloads for phone customers.

## TONS OF RIVALS

IF HELIO TAKES OFF, so could Dayton financially. Since Earthlink's merger in 2000 with MindSpring Enterprises, Dayton's stake in the combined company has shrunk to 1.8%, worth some \$17 million from \$123 million six years ago, after he sold off some shares and the stock tanked. To take on the Helio job, Dayton stepped down from the Earthlink chairmanship that he had held for 11 years. Now, he collects an undisclosed salary from the venture, with the potential



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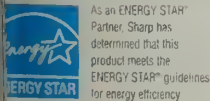
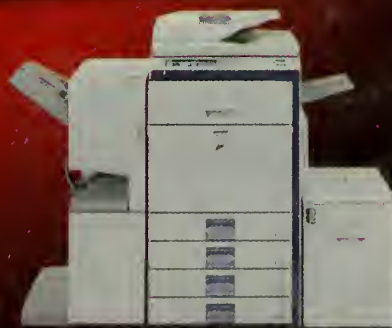


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Chris Johnson, Founder & CEO, Priasoft

Chris could always see beyond the garage where he started his software company. American Express could see beyond it, too. They gave him the financing and payment flexibility he needed before anyone else would. How long did it take his bank to realize he had a good idea? "Two years and two weeks too long," says Chris.

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## BIOBOX

### Return of the Surfer

His time Dayton is riding the wireless wave:



**BORN:** Aug. 8, 1971

**PERSONAL:** Married to novelist Arwen Elys Dayton; father of three. Surf fanatic.

**FIRST GIG:** At 18 he launched a Santa Monica (Calif.) coffee house, Café Mocha, with \$10,000 from his grandmother. Actress Alicia Silverstone got her first job there.

**THE BIG SCORE:** At 23, Dayton started Internet service provider Earthlink by stringing together 10 modems.

**THE BUMMER:** His 1999 eCompanies incubator/venture fund is still under water, despite launching cell phone game service JAMDAT and funding LowerMyBills.com.

**CATCHING A NEW WAVE?** Launched Wi-Fi service Boingo Wireless in 2001; Helio cell phones for upscale kids launched in May.

**QUOTE:** "The story isn't over at eCompanies. It's been six and half years, and we're still building."

deed, in addition to ads he has placed on MTV, SpikeTV, and the YouTube video site, some of Helio's promotions are specifically aimed at Korean Americans.

Success with either service would help Dayton live down the scorching that some big-name investors, including Disney, Goldman Sachs, First Boston, and Kohlberg Kravis Roberts, took in the eCompanies venture. Now largely dormant, eCompanies produced Boingo and Business.com, a site run by Dayton's partner, Winebaum. (Business.com is now financed in part by *BusinessWeek* parent The McGraw-Hill Companies Inc.) The fund had a few wins, such as cellular gaming site JAMDAT, which was bought by Electronic Arts Inc. But the original backers are still waiting to break even.

Dayton is undeterred. To promote Helio, he came up with the idea of sponsoring club parties and other events. And when Dayton's not pumping the product? You can find him holding surf clinics for the Helio staff. ■

## DEAN MODEL

EARTH LINK EXPECTS Helio to ring up million subscribers by 2009. That seems ambitious, seeing how other MVNOs have struggled. Dayton says Helio is modeled after wildly popular service that SK Telecom runs in South Korea. "Every kid I saw over here had one of their phones like jewelry hanging from their wrists," he says. In-

**BusinessWeek online** For an interview with Dayton go to [www.businessweek.com/extras/BusinessWeekWeekend](http://www.businessweek.com/extras/BusinessWeekWeekend): For a look at the future of technology in tennis, including the introduction of instant replay at this year's U.S. Open, watch BusinessWeek Weekend. Check local TV listings or go to [businessweekweekend.com](http://businessweekweekend.com) and type in your Zip Code.



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**CAPITAL IDEA** Segway is a popular conveyance with D.C. tourists

*Washington Post* soon was calling it "The Invention That Runs on Hype."

Kamen says every invention is a response to a problem. But the problem he wanted to solve—the need for a clean, energy efficient vehicle that could coexist with pedestrians and replace the car in the world's cities—was one that others didn't see.

## FUTURE AGNOSTIC

IN PREDICTING the future of technology, the hardest part might not be envisioning what can be invented, but determining what will be needed. There's an awful lot of amazing technology in the personal transporter, which is powered by computer-controlled electric motors that automatically keep the machine in balance in response to bumps in the road and the rider's movements. Still, when it comes to a clean, inexpensive, one-person transportation for many people a bike does just fine. Disabled users swear by the Segway, and police departments have adopted it, but that doesn't mean the personal transporter the game changer most people imagined. Thousands have sold, but not nearly as many as Segway hoped for.

Writing off Segway, however, would be a mistake. After all the hype and counterhype, there's still time for a very different second look. Kamen's vision of Segway was focused on a two-wheeled personal transporter. But Jan D. Norrod, the chief executive recruited a year and a half ago by Doerr, is pushing the company toward a much more expansive view of what Segway is about.

"I look at the technology," says Norrod, "and ask, 'Where else can it be used?'" Norrod's approach is what you can think of as future agnostic. "In his view, Segway needn't be a whole new urban ecology or replace the car. It can put its technology into anything that moves. That means unmanned vehicles

for potential military or industrial uses, or multiperson vehicles that use Segway's computers and electric engines to glide smoothly over obstacles. And Norrod thinks Segway's efficient electric motors could be central to a new generation of hybrid cars (yes, cars). Segway has already built a four-wheeled multiperson prototype. "If people want four wheels," says Norrod, "I should give 'em four wheels."

It's not the vision Kamen originally had. Still the chair of Segway, he had hoped to offer the grand solution to the problems of urban traffic and pollution. Instead, his technology offers the solution to a myriad of less all encompassing but still very important problems. "Life," Kamen says, "is short for incrementalism." It's a big statement, and, simply, untrue. Incrementalism might inspire an initial burst of invention, but men is definitely the expert on that)

it's a pretty good description of how inventions actually make it into the world when the publicity is gone. ■

## OFF-ROAD

One new Segway is designed for play



# Reinventing the Wheel, Slowly

Segway hasn't transformed city life, but its technology may yet become pervasive

BY MARK GIMEIN

**S**EGWAY, THE COMPANY STARTED by noted inventor Dean Kamen with the modest goal of changing the way the world moves on two feet, recently introduced two new models of its "personal transporter." If you missed it, you're forgiven. It was an announcement met with an impressive silence.

The first Segway—a clean-running, technologically dumbfounding, fun-as-hell-to-ride device that was pretty much impossible to fall off of—was introduced to so much fanfare five years ago that the public-relations agency that helped engineer it still uses it as a case study in how to create a media frenzy. It may be an even better case study in media backlash. The initial euphoria had hardly worn off before a new consensus emerged: This was all much ado about a \$5,000 scooter. Journalists liked riding it, but they couldn't figure out who would buy it. John Doerr, the Silicon Valley eminence who backed it, had said entire cities would be redesigned around it. Instead, *The*

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# Investing in America's Energy Future 🍏

Robert Stempel, who once ran General Motors, is today focused on changing the dynamics of transportation, as chairman and CEO of Energy Conversion Devices Inc. (ECD Ovonic), a 500-employee company in Rochester Hills, Mich. This company's many divisions are either producing technologies to enable the transition to a more sustainable energy future, or they're inventing them — for instance, the nickel-metal-hydride battery technology that powers today's hybrid vehicles. Few actions speak louder than Stempel's.

OGE

# Transportation Seeks a New Balance

**Concern for the environment and energy security are driving innovation that's changing the face of mobility**

From small-time innovators to the world's largest corporations, an increasing level of attention is focusing on reshaping the world of transportation. The reason is hardly a secret: With oil at more than 70 per barrel, fuels that made less economic sense in the past, or technologies that offer real fuel savings, are looking mighty attractive.

Worldwide energy use by cars and trucks has more than doubled over the past 30 years. With a growing fleet of personal use vehicles in the U.S., and a massive increase in China and India, simply drilling for more oil isn't the answer. Hence, interest has spiked in biofuels like ethanol and biodiesel, as well as such longstanding motor fuel alternatives as natural gas and more future-focused fuels like hydrogen.

"The transportation sector faces two really big challenges," says Christopher Wilks, vice president of future fuels at BP, one of the world's largest energy companies.

"One is the need to diversify transportation fuels, which currently are almost totally reliant upon crude refining. The second big challenge is dealing with emissions of greenhouse gases." BP's approach is to make today's fuels better to provide improved environmental performance, while also actively working to introduce alternative fuels into the market — an approach mirrored in many parts of the transportation world. Although transportation isn't the chief culprit in greenhouse gas emissions, Wilks notes that BP intends to provide low-carbon solutions for both the transport and power sectors.



**Pump Me Up** BP's focus: making today's liquid fuels more environmentally compatible while working to bring alternative fuels to market.

## g on Biofuels

Biofuels, which today account for less than 2% of global transportation fuels, could become a significant part of the transport fuel mix in the future — possibly up to 20% to 30% in key markets. BP has become a major player in biofuels over the past 25 years. "BP is very active in looking at some of the alternatives to fossil fuels for road transportation," says Wilks. Today, BP's biofuel activities account for 10% of the global biofuels market, with the company blending and distributing 70 million gallons of ethanol and 70 million gallons of biodiesel over the past year alone.

In addition to BP's biofuels business, in June 2006 the company created a new Energy Biosciences Institute (EBI), the first research

## A Letter from Samuel W. Bodman, Secretary of Energy

Over the past century our Nation's growing use of gasoline-powered vehicles — for both business and pleasure — has led to an over-reliance on hydrocarbons, specifically petroleum. To quench this thirst for gasoline, America must import about 15 million barrels of crude oil every day. This clearly displays an uncomfortable dependence on foreign sources of energy.

To help reduce this dependence, President Bush launched the Advanced Energy Initiative, which provides a \$383 million increase in clean energy research at the U.S. Department of Energy. This funding will be used for new vehicle technologies in efficient hybrid and lithium batteries, advancements in cellulosic ethanol for fuel, and additional research in solar and wind power.

While the Energy Department remains committed to providing research and support critical to diversifying our Nation's energy portfolio, we also need our partners in industry, academia, and at our national laboratories to continue their creativity and ingenuity to help us reach our national energy goals. Together, we can help tip the scales and bring more environmentally friendly, domestically produced fuels into the marketplace soon.

Together, the Energy Department and industry are investing in hydrogen fuel cells and are furthering hybrid and "plug-in" technology for electric cars; both are becoming increasingly attractive and affordable options for consumers. We are making great strides at reducing the production cost of alternative fuels such as ethanol, cellulosic ethanol, and biodiesel, as well as fuels produced from biomass.

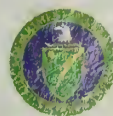
These fuels burn cleaner and in many cases, can be used in conventional vehicles already on the road. And that is just the beginning. With a focused strategy and efficient use of resources, the Bush Administration will continue to light the path toward a stable and secure energy future.

I thank *BusinessWeek* for producing this landmark section, and for bringing attention to the important work taking place at the Department of Energy.

Sincerely,

*Samuel W. Bodman*

Samuel W. Bodman  
Secretary of Energy





center of its kind in the world, to provide a pipeline of new biofuels technology. BP plans to invest \$500 million over 10 years in the EBI to conduct radical research aimed at probing the emerging secrets of bioscience and applying them to the production of new and cleaner energy, principally fuels for road transport.

Currently, biofuels are primarily based on feedstocks such as corn, sugar cane and beet, and wheat. But research is ongoing to create affordable biofuels from sources other than food crops, principally cellulosic ethanol — alcohol fuel made from corn stalks and residue, woody grasses, municipal waste, and other sources.



**Straw into Gold** Today, renewable biofuels are being made from sources like corn. Substantial work is being done that will lead to commercial production of ethanol from feedstocks like woody grasses and other biomass.

BP is also working with DuPont to create biobutanol, a biofuel that offers several advantages while also being synergistic with today's vehicles and fueling infrastructure. Biobutanol is produced from the same agricultural sources as bio-ethanol and will be compatible with future cellulosic feedstocks. Existing ethanol facilities can be cost-effectively retrofitted to produce biobutanol, with minor changes in fermentation and distillation.

Biobutanol has great promise. It can be added in volumes of up to 16% in gasoline without requiring any vehicle changes; its energy content is much closer to gasoline's than bio-ethanol; low vapor pressure enables it to be easily blended with conventional gasoline; plus it is potentially suitable for transport in pipelines, unlike existing biofuels.

Of course, the practical advantages of traditional fuels — including their high energy density that facilitates on-board storage and their ease of transport through a well-developed infrastructure — explain why oil is likely to be around for the long term and why BP is also working to improve its

advanced gasoline and low-sulfur diesel fuel formulations to achieve better environmental performance.

## Automakers on Board

In recent years, automakers have developed and sold more than 5 million sedans, trucks, and SUVs capable of running on gasoline and/or ethanol from the same tank — so-called flexible-fuel vehicles, or FFVs. Ford Motor Co. has produced more than 1.6 million of these over the past decade, will turn out up to another 250,000 FFVs this year alone, and has committed to double its annual production of biofuel-capable vehicles in the U.S. by 2010. Ford is working with VeraSun Energy Corp.

to establish a Midwest Ethanol Corridor, between Chicago and Kansas City, to increase the availability of E85 ethanol fuel for FFV drivers.

"We share the excitement around the potential of second-generation biofuels, both cellulosic bio-ethanol and biomass to liquid," says Gerhard Schmidt, vice president of research and advanced engineering at Ford. "These promise to achieve 'well-to-wheel' CO<sub>2</sub> emissions similar to Ford's hydrogen fuel-cell vehicles and can be produced in significant volumes." According to Schmidt, these biofuels offer the potential advantage of being

backward-compatible with the nation's existing vehicle fleet.

Beyond biofuels, Ford fields a diverse portfolio of vehicles and advanced fuels. The company pledges to make internal combustion powertrains better in every way, including diesel and gasoline engines with advanced engine control, turbochargers, and other technologies. Ford, among others, is developing and test-marketing hydrogen internal-combustion commercial vehicles. It's also at the forefront of hydrogen-fuel-cell development and is the only North America-based automaker that delivers a full hybrid today, with more hybrid models coming.

## Hydrogen on the Road

While hydrogen is broadly viewed as a potential "future" fuel, it is being implemented now in certain high-profile transportation activities. "Enabling the use of hydrogen in a hybrid's internal-combustion engine demonstrates how we can displace fossil fuel in the gasoline-electric hybrid equation today," says ECD Ovonic's Stempel, pointing to



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company's hydrogen hybrid demonstrators that showcase the use of solid metal hydrogen storage. He adds that such vehicles provide both high fuel economy and true zero-emissions performance, and that commercializing hydrogen hybrids will lead to a hydrogen fueling infrastructure that will in turn pave the way for fuel-cell vehicles.

Technology companies like UTC Power, a South Windsor (CT)-based unit of United Technologies Corp., have also zeroed in on hydrogen fuel cells. "We're leveraging the technology we've developed over the many years we have been involved in the NASA space programs," says Jan van Dokkum, president of UTC Power, which supplies the space shuttle's fuel cells. "We have worked with BMW, Nissan, Hyundai, and most of the leading automotive companies in the world on some form of technology or demonstration program. Elements of our technology will eventually be included in their automotive products."

UTC Power also has its sights on buses and fleet vehicles, including delivery vehicles, waste hauler trucks, and public transportation. The reasons, according to van Dokkum: these vehicles are used on predictable routes and require only one central fueling station for the fleet; many are sensitive to fuel costs; and hydrogen fuel cells are very efficient when applied to fleet transportation. A fuel-cell vehicle's electric drive provides maximum torque from zero rpm, ideal for moving heavy commercial vehicles at the low speeds often traveled on their routes. Specialty vehicles like lift trucks, airport support vehicles, and light-duty transportation for distribution warehouses and enclosed facilities are also ideal fuel-cell candidates.

In California, UTC Power has provided fuel-cell power plants for three hybrid-electric transit buses on the road in San Francisco/Oakland with AC Transit and one in Palm Springs with SunLine Transit. Says van Dokkum, "These are the first of their kind in the U.S. and are two to three times more efficient than a normal diesel-powered city bus, because of the combined benefits of the fuel cell and electric motor together with hybrid drive and regenerative braking."

### A Natural Alternative

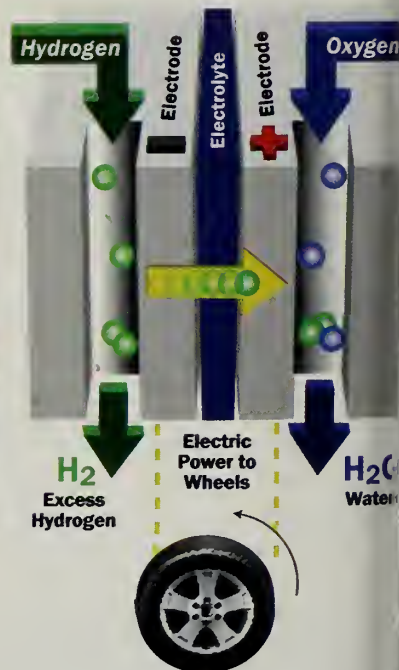
To compete with gasoline and diesel, alternative fuels must make sense on many levels. Alternative-fuel vehicles must meet increasingly stringent emissions regulations, operate in ways familiar to a driver, and be cost-competitive with conventional fuels. Ideally, an alternative fuel should be abundant in the U.S., to promote energy self-sufficiency.

According to James N. Harger, senior vice president of marketing and sales at Clean Energy, in Seal Beach, Calif., natural-gas vehicles meet these criteria perfectly. This extremely clean-burning alternative fuel has been successfully used for decades in light trucks, passenger vehicles, and commercial and transit buses. Now, with the introduction of Honda's Civic GX natural-gas sedan to consumers in California and soon in New York, natural-gas vehicles are extending into new markets.

Large fleet operators are also turning to compressed natural gas. Says Harger: "This is increasingly driven by simple economics. We're providing a bundled natural gas rate, including the fueling station, to refuse operators and



**Hydrogen Hits the Road** Efficiency is key as UTC Power moves commercial transport to a new level with hydrogen fuel-cell technology (above). Hydrogen creates electricity to power drive motors, with water as a byproduct (diagram).



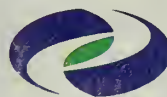


**Clean Energy** is the largest provider of vehicular natural gas (CNG and LNG) in North America with a broad customer base in the refuse, transit, shuttle, taxi, police, intrastate and interstate trucking, airport and municipal fleet markets. Tens of thousands of vehicles fuel daily at strategic locations in the United States and Canada.

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## Driving Biofuels into the Mainstream

With global demand for transportation fuels rising rapidly, industry leaders are seeking innovative ways to deliver new and renewable forms of energy. One key strategy: biofuels.

BP is committed to bringing biofuels into the mainstream by making them more widely available to the market. BP has been selling biofuels for more than 25 years, and today is a top player in the global biofuels market, blending and distributing 590 million gallons of ethanol and 70 million gallons of biodiesel in 2005.

The company also is leading the way by investing in a range of biofuel-related activities around the world. "We expect demand for biofuels to rise significantly through the next decade to meet consumer desire for more environmentally responsible products and to satisfy the requirements of government for more energy to be home-grown," says BP Chief Executive Lord Browne. "BP's biofuels business will bring together all our existing activities in this area and also identify a selection of new demonstration projects to increase our knowledge and expertise, which is essential to bring these products to market on a wide scale."

BP, which is dedicated to identifying low-carbon and renewable fuels for the future, recently announced its pledge of \$500 million over 10 years to fund an Energy Biosciences Institute (EBI). "The world needs new technologies to maintain adequate supplies of energy for the future," says Browne. "Bioscience is already transforming



Conventional biofuels can help reduce greenhouse emissions and even more significant reductions could be achieved using advanced biofuels.

Modern medicine, and we believe can bring immense benefits to the energy sector. By creating this integrated and dedicated research center, we plan to harness a technical discipline with enormous potential to provide new energy solutions."

In addition, BP recently announced a new collaboration with DuPont that is expected to create the next generation of biofuels. Teams of bioscientists and fuels technologists from the two companies are working together to develop advanced biofuels. The first product will be biobutanol. Biobutanol can be blended with gasoline or gasoline containing ethanol, is compatible with existing vehicle technology, and has the potential to be incorporated into the existing fuel supply infrastructure.

"BP has a history of seeking and delivering ways to reduce greenhouse gas emissions, both in our own operations and from the products we sell," says Browne. "Consumers want energy which is clean and local, and biofuels are one very attractive means of meeting that demand."

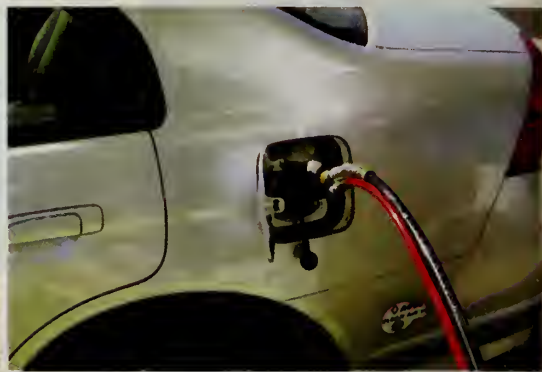
# Some biofuel for thought.

BP has been selling biofuels in the U.S. for more than 25 years. In 2005, BP fuels contained more than 575 million gallons of biofuels. Today, they're available in more than 20 U.S. states. It's a start.



beyond petroleum®





**Taking the High Road** California-based company Clean Energy fuels the movement of clean natural gas commercial fleet and passenger vehicles into the mainstream.

transit agencies for under \$2 a gallon. We can also provide fuel on a fixed-rate basis for several years." Some Clean Energy customers, like transit operators El Paso Sun Metro, Dallas Area Rapid Transit, and Phoenix Transit, have multi-year contracts at a fixed fuel rate of well below \$1.70 per diesel gallon equivalent.

"The 2007-2010 emission requirements on diesel are also going to increase the cost of a diesel engine, not just because of the fuel, but also because of efficiency decreases," adds Harger. "Natural-gas engines in 2007 will meet the 2010 standards with a simple, off-the-shelf catalyst that's available today, compared to diesel operators that will have to include ammonia/urea injection with diesel fuel and add post-combustion diesel particulate traps that are expensive to operate and maintain."

## New Directions Unfolding

If there is a reliable roadmap for the future, it shows both the automotive and energy industries moving on parallel tracks. A discernible momentum is taking the transportation industry in radically new directions, encompassing the best that advanced fuels, technologies, science, and imagination can bring to address our very real energy and environmental challenges.

New solutions like the biobutanol being developed by BP and DuPont, in collaboration with automotive manufacturers such as Ford, are an important part of this process. "Specific advantages that biobutanol offers facilitate getting a bio-gasoline component into the mainstream functional fuel pool, and into the pool at higher concentrations," says BP's Wilks. "This responds not only to diversification, but also to the goal of lower greenhouse-gas emissions. The more renewably produced components we introduce into the fuel pool, the greater impact we can have on reducing these emissions."

No single fuel or technology prevails, outside of the recognition that internal combustion will dominate for many years. Sums up Ford's Schmidt: "I think everyone is looking for the silver bullet that solves everything, but the future will be much more complex than it appears to be, and no longer 'one size fits all.'"

## Web Directory

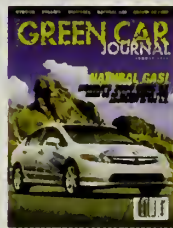
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**SCHAPIRO** She cut her teeth in the commodity markets

# Staying Ahead of the Scam Artists

NASD's new chief is zeroing in on ways to prevent retirees from being bilked

FAMILY THORNTON

**W**ARNING TO WALL Streeters angling to make big bucks from the coming wave of boomer retirees: Mary L. Schapiro is watching. On Sept. 1, Schapiro, one of the most steadfast enforcers, became executive of NASD, a watchdog become tougher of late. And her top priority is that many retirees are ill-prepared to evaluate increasingly complicated investment products, not to mention the seamier tricks of the trade. "We need to think about how we are arming people," says Schapiro, "and make sure they have a secure retirement." Schapiro, who is both soft-spoken and knows what she's up against. For years at NASD she has honed an ability to get firms' cooperation while stamping out wrongdoing. Schapiro has been called "the regulator," says Barbara Roper, director of investor protection at the Con-

sumer Federation of Americas. "NASD regulation has made enormous strides."

The spark for Schapiro's interest in regulation stems from 1980, when the daughter of an antiques dealer and a librarian graduated from law school. Nelson Bunker Hunt and William Herbert Hunt were front-page news for attempting to corner the silver market. Schapiro was fascinated "that a couple of people thought they were rich and powerful enough...to get away with manipulating markets that affected millions of people."

## BIO

### Mary L. Schapiro

**BORN** June 19, 1955, in New York, second of four children. Father was an antiques dealer; mother a college librarian.

**EDUCATION** BA, 1977, Franklin & Marshall College; JD, 1980, George Washington University.



Law firms dangled big bucks, but she signed on in enforcement at the Commodity Futures Trading Commission.

## DARK HOURS

SCHAPIRO SOON displayed her dogged nature. When she built up the CFTC's enforcement division as its chairman in 1994, the then-head of the Chicago Board of Trade, Thomas R. Donovan, said he wouldn't be intimidated by a "blonde 5-ft.-2-in. girl." Schapiro shot back that she was 5-ft.-5. And when rogue trades in Singapore had Barings Bank on the brink of collapse, she called all over the country at 3 am to locate its top monetary authority and urge him to reassure the markets.

A move to NASD in 1996 coincided with the agency's darkest hour. It was being probed for its role in a price-fixing scandal. Schapiro overhauled enforcement and, as vice-chairman since 2002, spoke out against shenanigans involving sales of everything from college savings plans to mutual funds. She also launched a task force to get ahead of potential problems.

Now, Schapiro is zeroing in on ways retirees are being roped into inappropriate investments. On her hit list: stocks of companies that fraudulently claim to have devised revolutionary energy solutions, investments with risky futures and options, and some hyped insurance products. Recently, Schapiro sent staffers to seminars financial firms hold for senior citizens to evaluate sales pitches and products. "I'd be surprised if some enforcement actions didn't come out of the sweep," she says.

NASD is also creating educational brochures for seniors, and hopes to simplify the disclosure statements firms provide. For that, Schapiro needs support from the companies she oversees, which foot her budget. Some are grouching about regulatory overreach, even proposing NASD adopt a "bill of rights." So Schapiro recently went on a "listening tour," and stresses that NASD will be more transparent. But, she adds: "We are a regulator. That's our reason for existing." ■

**CAREER PATH** Commodity Futures Trading Commission in 1980; Futures Industry Assn. from 1984 to 1988; Securities & Exchange Commission from 1988 to 1994; CFTC until 1996; NASD for the past 10 years.

**FAMILY** Married to a lawyer. Two daughters. Two dogs adopted from the Animal Rescue League.



Cover Story

# Nightmar

**SOMERSET, WIS.**  
Eric and Jennifer  
Hinz didn't expect  
their 1% teaser  
rate to jump  
to 7.68%





# Mortgages



They promise the American Dream: A home of your own—with ultra-low rates and payments anyone can afford. Now, the trap has sprung

*By Mara Der Hovanesian*

**F**OR CASH-STRAPPED HOME-owners, it was a pitch they couldn't refuse: Refinance your mortgage at a bargain rate and cut your payments in half. New home buyers, stretching to afford something in a super-heated market, didn't even need to produce documentation, much less a downpayment.

Those who took the bait are in for a nasty surprise. While many Americans have started to worry about falling home prices, borrowers who jumped into so-called option ARM loans have another, more urgent problem: payments that are about to skyrocket.

The option adjustable rate mortgage (ARM) might be the riskiest and most complicated home loan product ever created. With its temptingly low minimum payments, the option ARM brought a whole new group of buyers into the housing market, extending the boom longer than it could have otherwise lasted, especially in the hottest markets. Suddenly, almost anyone could afford a home—or so they thought. The option ARM's low payments are only temporary. And the less a borrower chooses to pay now, the more is tacked onto the balance ("Dubious options," page 72).

The bill is coming due. Many of the option ARMs taken out in 2004 and 2005 are resetting at much higher payment schedules—often to the astonishment of people who thought the low installments were fixed for at least five years. And because home prices have leveled off, borrowers can't count on rising equity to bail

THOMAS STRAND



them out. What's more, steep penalties prevent them from refinancing. The most diligent home buyers asked enough questions to know that option ARMs can be fraught with risk. But others, caught up in real estate mania, ignored or failed to appreciate the risk.

There was plenty more going on behind the scenes they didn't know about, either: that their broker was paid more to sell option ARMs than other mortgages; that their lender is allowed to claim the full monthly payment as revenue on its books even when borrowers choose to pay much less; that the loan's interest rates and up-front fees might not have been set by their bank but rather by a hedge fund; and that they'll soon be confronted with the choice of coughing up higher payments or coughing up their home. The option ARM is "like the neutron bomb," says George McCarthy, a housing economist at New York's Ford Foundation. "It's going to kill all the people but leave the houses standing."

Because banks don't have to report how many option ARMs they underwrite, few choose to do so. But the best available estimates show that option ARMs have soared in popularity. They accounted for as little as 0.5% of all mortgages written in 2003, but that shot up to at least 12.3% through the first five months of this year, according to FirstAmerican LoanPerformance, an industry tracker. And while they made up at least 40% of mortgages in Salinas, Calif., and 26% in Naples, Fla., they're not just found in overheated coastal markets: Through Mar. 31 of this year, at least 51% of mortgages in West Virginia and 26% in Wyoming were option ARMs. Stock and bond analysts estimate that as many as 1.3 million borrowers took out as much as \$389 billion in option ARMs in 2004 and 2005. And it's not letting up. Despite the housing slump, option ARMs totaling \$77.2 billion were written in the second quarter of this year, according to investment bank Keefe, Bruyette & Woods Inc.

## The First Wave

AFTER PROLONGING THE boom, these exotic mortgages could worsen the bust. They also betray such a lack of due diligence on the part of lenders and borrowers that it raises questions of what other problems may be lurking ("Worst practices," page 78). And most of the pain will be borne by ordinary people, not the lenders, brokers, or financiers who created the problem.

## Dubious Options

A typical option ARM starts out with four **payment choices**. The minimum payment, which doesn't cover the interest charges, increase by 7.5% a year. The **interest rate**, meanwhile, adjusts every month. When borrowers choose to make the minimum payment, the shortfall tacked onto the balance. Once the balance has climbed by 10% or 15% **the loan resets**, and the new balance is amortized over the remaining life of the 30-year term. At that point, **paying a minimum** is no longer a option. As the numbers show, the reset can happen in a hurry. The following example assumes a \$500,000 loan with a term of 30 years.

| PAYMENT OPTIONS                   | MONTHLY PAYMENT* | ADDITIONAL INTEREST ADDED TO BALANCE |
|-----------------------------------|------------------|--------------------------------------|
| FULLY AMORTIZING 15-YEAR          | \$4,601.03       | \$0                                  |
| FULLY AMORTIZING 30-YEAR          | 3,455.08         | 0                                    |
| INTEREST-ONLY PAYMENT             | 3,073.26         | 0                                    |
| MINIMUM PAYMENT YEAR 1            | 1,608.20         | 20,214.81                            |
| PAYMENT AFTER RESET IN MONTH 29** | 4,107.86         | 50,357.28                            |

\*The numbers assume an initial rate of 7.38%, increasing to 7.95% during the first year and then holding constant. The initial minimum payment is based on a 1% minimum payment rate. The reset is based on the loan principal reaching 110% of the original loan.

\*\*Assumes borrower made only minimum payments.

Data: Keefe, Bruyette & Woods

Gordon Bürger is among the first wave of option ARM casualties. The 42-year-old police officer from a suburb of Sacramento, Calif., is stuck in a new mortgage that's making him poorer by the month. Bürger, a solid earner with clean credit, has bought and sold several houses in the past. In February he got a flyer from a broker advertising an interest rate of 2.2%. It was an unbeatable opportunity, he thought. If he refinanced the mortgage on his \$500,000 home into an option ARM, he could save \$14,000 in interest payments over three years. Bürger quickly pulled the trigger, switching out of his 5.1% fixed-rate loan. "The payment schedule looked like what we talked about, so I just started signing away," says Bürger. He didn't read the fine print.

After two months Bürger noticed that the minimum payment of \$1,697 was actually adding \$1,000 to his balance every month. "I'm not making any ground on this house; it's a loss every month," he says. He says he was told by his lender, Minneapolis-based Homecoming Financial, a unit of Residential Capital, the nation's fifth-largest mortgage shop, that he'd have to pay more than \$10,000 in prepayment penalties to refinance out of the loan. If he's unhappy, he should take it

up with his broker, the bank said. "I know they're selling crap, and they're selling it in a way that's very deceiving," says Bürger. "Unfortunately, I got sucked in." In a written statement, Residential Capital couldn't comment on Bürger's loan, but said that "each mortgage is designed to meet the specific financial needs of a borrower."

The loans certainly meet the needs of the banks. Option ARMs offer several payment choices each month. Among Bürger's alternatives were one for \$2,000 a month, another for \$1,697 a month, and a third for \$1,697 a month plus interest. The \$1,697 he pays. Why would his lender make the minimum so low? Thanks to perfectly legal accounting practices, the matter how little Bürger pays each month, the bank gets to record the minimum.

Option ARMs were created in 1980 for years were marketed to well-heeled home buyers who wanted the option of making low payments most months and then paying off a big chunk all at once. For them, option ARMs offered flexibility.

So how did these unusual loans get into the hands of so many ordinary folks? The sequence of events was orderly and rational, at least within a flawed system.





**They know they're selling crap,  
and they're doing it in a way that's  
very deceiving"**

*—Sacramento police officer  
Gordon Burger*

early years of the housing boom, low interest rates made safe fixed-rate loans attractive to borrowers. As home prices soared, banks pushed adjustable-rate loans with lower initial payments. When those got too pricey, banks hawked loans that required only interest payments for the first few years. And then they sold option ARMs—not as financial-hedging tools for the wealthy but as affordability tools for the masses. Banks had an army of unregulated mortgage brokers to do what needed to be done to keep the money flowing, even if it meant putting dangerous loans in the hands of

people who couldn't handle or didn't understand the risk. And Wall Street greased the skids by taking on much of the new risk banks were creating.

Now the signs of excess are crystal clear. Up to 80% of all option ARM borrowers make only the minimum payment each month, according to Fitch Ratings. The rest of the money gets added to the balance of the mortgage, a situation known as negative amortization. And once balances grow to a certain amount, the loans automatically reset at far higher payments. Most of these borrowers aren't paying down their loans; they're under-

paying them up.

Yet the banking system has insulated itself reasonably well from the thousands of personal catastrophes to come. For one thing, banks can sell some of their option ARMs off to Wall Street, where they're packaged with other, better loans and resold in chunks to investors. Some \$182 billion of the option ARMs written in 2004 and 2005 and an additional \$83 billion this year have been sold, repackaged, rated by debt-rating agencies, and marketed to investors as mortgage-backed securities, says Bear, Stearns & Co. Banks also sell an unknown amount of them directly to hedge funds and other big investors with appetites for risk.

The rest of the option ARMs remain on lenders' books, where for now they're generating huge phantom profits for some lenders. That's because, according to generally accepted accounting principles, or GAAP, banks can count as revenue the highest amount of an option ARM payment—the so-called fully amortized amount—even when borrowers make



only the minimum payment. In other words, banks can claim future revenue now, inflating earnings per share.

For many industries, so-called accrual accounting, which lets companies book sales when they contract for them rather than when they receive the cash, makes sense. The revenues will eventually come. But accrual accounting doesn't apply well to option ARMs, since it's more difficult to know if unpaid interest will ever cross a banker's desk. "This is basically an IOU that may never get paid," says Robert Lacoursiere, an analyst at Banc of America Securities. James Grant of *Grant's Interest Rate Observer* recently wrote that negative-amortization accounting is "frankly a fraudulent gambit. But what it lacks in morality, it compensates for in ingenuity." The Financial Accounting Standards Board, which is responsible for keeping GAAP up to date, stands by its standard but told *BusinessWeek* in a written statement that it is "concerned that the disclosures associated with these types of loans [are] not providing enough transparency relative to their associated risks."

## Camouflaged Losses

RISKS OR NOT, THE accounting treatment is boosting reported profits sharply. At Santa Monica (Calif.)-based FirstFed Financial Corp., "deferred interest"—what an outsider might call phantom income—made up 67% of second-quarter pretax profits. FirstFed did not respond to requests for comment. At Oakland (Calif.)-based Golden West Financial Corp., which has been selling option ARMs for two decades, deferred interest made up about 59.6% of the bank's earnings in the first half of 2006. "It's not the loan that's the problem," says Herbert M. Sandler, CEO of World Savings Bank, par-

ent of Golden West. "The problem is with the quality of the underwriting."

In the middle of one of the hottest U.S. markets, Coral Gables (Fla.)-based BankUnited Financial Corp. posted a \$14.8 million loss for the quarter ended June, 2005. Yet it reported record profits of \$23.8 million for the quarter ended in June of this year—\$20.9 million of which was earned in deferred interest. Some 92% of its new loans were option ARMs. Humberto L. Lopez, chief financial officer, insists the bank underwrites carefully. "The option ARMs have gotten a bit of a raised eyebrow because we generate and book noncash earnings. But...it's our money, and we do feel comfortable we'll get it back."

Even the loans that blow up can be hidden with fancy bookkeeping. David Hendler of New York-based CreditSights, a bond research shop, predicts that banks in coming quarters will increasingly move weak loans into so-called held-for-sale accounts. There the loans will sit, sequestered from the rest of the portfolio, until they're sold to collection agencies or to investors. In the latter case, a transaction on an ailing loan registers on the books as a trading loss, gets mixed up with other trading activities and—presto!—it vanishes from shareholders' sight. "There are a lot of ways to camouflage the actual experience," says Hendler.

There's no way to camouflage what Harold, a former computer technician who asked *BusinessWeek* not to publish his last name, is about to face. He's disabled and has one source of income: the \$1,600 per month he receives in Social Security disability payments. In September, 2005, Harold refinanced out of a fixed-rate mortgage and into an option ARM for his \$150,000 home in Chicago. The minimum monthly payment for the first year is \$899, which he can afford.

## Home Disadvantage



### THE HOME BUYERS

Average Jane and Joe, eager to own a piece of the American Dream. Unsophisticated about exotic mortgage products such as option ARMs, which they use to buy pricier houses than they can afford. If they need to sell in a hurry, they may find that rather than building equity, they've buried themselves under a heap of debt.

The interest-only payment is \$1,454, which he can't. The fully amortized payment is \$1,454, which his lender, Wilmington Mutual, gets to count on its books. WaMu, no fly-by-night operation, says it couldn't comment on Harold's case, citing confidentiality issues. A spokesman says the bank "accounts for its option ARM product in accordance with generally accepted accounting principles." WaMu has about \$12 billion in loans actively amortizing right now, up from \$2.5 billion in 2005, estimates CreditSights' Hendler. In a written statement, WaMu said "borrowers who request an adjustable loan with payment options should understand those options and potential adjustments throughout the life of the loan."

addendum

ad nauseam

ame almost every player wins—except for the cash-strapped homeowner



### THE ORIGINATORS

Commission-hungry mortgage originators, part of an independent regulated salesforce for borrowers, are untethered to the financial health of buyers. They receive 80% of all mortgage fees and extra bonuses for selling exotic products with few penalties.



### THE LENDERS

Big banks love option ARM mortgages because they can book all of the earnings up front even though the borrower may never pay in full. To keep the mortgage spigots gushing, banks are underwriting riskier loans to less creditworthy customers.



### THE DISTRIBUTORS

In search of big fees from underwriting and bundling securities, Wall Street is buying mortgage loans aggressively, often without scrutiny. Loans are bundled for sale according to the risk appetite of professional investors.



### THE RISK SEEKERS

Hedge funds and other professional investors have an insatiable thirst for yield in a low-return market. They'll buy almost anything at the right price, and they factor defaults into the terms they set, insulating their portfolios from major losses.

ban. We make detailed disclosures to borrowers that are designed to develop a more informed consumer of mortgage products and ensure that our customers are comfortable with the loan products they select."

### Hard Sell

LET THE DEALS done, banks have turned increasingly to unregulated mortgage brokers, who now account for 80% of mortgage originations, double what it was 10 years ago, according to the National Association of Mortgage Brokers. In 2004 banks began offering fatter sales commissions on option ARMs to encour-

age brokers to push them, says Gail McKenzie, assistant U.S. attorney in Atlanta, who is investigating mortgage brokers for improper practices.

The problem, of course, is that many brokers care more about commissions than customers. They use aggressive sales tactics, harping on the minimum payment on an option ARM and neglecting to mention the future implications. Some even imply verbally that temporary teaser rates of 1% to 2% are permanent, even though the fine print says otherwise. It's easy to confuse borrowers with option ARM numbers. A recent Federal Reserve study showed that one in four homeowners is mystified by basic adjustable-rate loans. Add multiple payment options

into the mix, and the mortgage game can be utterly baffling.

Billy and Carolyn Shaw are among the growing ranks of borrowers who have taken out loans they say they didn't understand. The retired couple from the Salinas (Calif.) area needed to tap about \$50,000 in equity from their \$385,000 home to cover mounting expenses. Billy, 66, a retired mechanic, has diabetes. Carolyn, 61, has been caring for her grandchildren, 10-year-old twins, since her daughter's death in 2000. The Shaws have a fixed income of \$3,000 a month that will fall by about \$1,000 in November after Billy's disability benefits run out. Their new loan's minimum payment of about \$1,413 is manageable so far, but the

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fully amortized amount of about \$3,329 is out of the question. In a little over a year, they've added some \$8,500 to their loan balance and now face a big reset if they continue to pay only the minimum. "We didn't totally understand what was taking place," says Carolyn. "You have to pay attention. We didn't, and we're really stuck here." The Shaws' lender, Golden West, says it routinely calls customers to ask them if they are happy and understand their mortgage loan.

Then there's the illegal stuff. Mortgage fraud is one of the fastest-growing white-collar crimes in the nation, costing \$1 billion in 2005, double the year before. A slower housing market could foster more wrongdoing. "With a tighter market, you are going to find there is more incentive to manipulate," says Tim Irvin of Irvin Investigations & Research Services in Spring, Texas. "Brokers are having a harder time getting business, so they're getting creative."

Concerns like these haven't curbed Wall Street's hunger for option ARMs. "At a price, you can originate or sell anything," says Thomas F. Marano, global head of mortgage and asset-backed securities at Bear Stearns. Hedge funds have been particularly active, buying risky

**You have to pay attention. We didn't, and we're really stuck here**

—Carolyn Shaw, with her husband a retired mechanic. In a little over a year, they've added some \$8,500 to their loan balance, with a big reset coming if they continue to pay monthly minimums on their Salinas (Calif.) area

loans directly from banks and cutting out the bundlers in the middle. Kathleen C. Engel, an associate professor of law at Cleveland-Marshall College of Law at Cleveland State University, says Wall Street and hedge fund money has helped to finance widespread lending abuses, particularly among the most vulnerable borrowers.

## Pros Go Unscathed

WHY ARE HEDGE FUNDS willing to buy risky loans directly? Because they can demand terms that help insulate them from losses. And banks, knowing what the hedge funds want in advance, simply take it out of the hides of borrowers, many of

whom qualify for lower rates based on their credit histories. "Even if the hedge goes bad, [the hedge funds are] still getting money hand over fist," says Engel.

Eventually, some of it will go south. The Wall Street pros who buy option ARMs are in the business of managing risk, and no one expects widespread losses. They've taken on billions in iffy option ARMs, but the loans are no shake-ups. The billions in emerging market derivatives they buy and sell all the while. Blowups are factored into the investment decision.

Banks that hold lots of option ARMs in their books will surely be hit by losses in coming years. "It's certainly reasonable to expect to see some exposure wrung out," says Brad A. Morrice,

## AVALON

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 **TOYOTA** | *moving forward* 



dent and CEO of New Century Financial Corp. But even here the damage will likely be limited. Banks use insurance and other financial instruments to protect their portfolios, and they hold real assets—homes—as collateral. Christopher L. Cagan, director of research and analytics at First American Real Estate Solutions, a researcher and unit of title insurer First American, forecasts total defaults of \$300 billion across all types of loans, not just option ARMs, over the next five

years—less than 1% of total homeowner equity. (In comparison, JPMorgan Chase & Co. alone has a mortgage portfolio of \$182.8 billion.) Cagan estimates that banks will end up losing only \$100 billion of it all told.

Most of the pain will be born by ordinary people. And it's already happening. More than a fifth of option ARM loans in 2004 and 2005 are upside down—meaning borrowers' homes are worth less than their debt. If home prices fall 10%, that

number would double. "The number of houses for sale is tripling in some markets, so people are not going to get out of their debt," says the Ford Foundation's McCarthy. "A lot are going to walk."

Jennifer and Eric Hinz of Some Wis., are feeling the squeeze. They financed out of a 5.25% fixed-rate, 30-year loan in June, 2005, and into an option ARM with a 1% teaser rate from Indy Bank. The \$1,483 payment for their original mortgage dropped to as low as \$

## Worst Practices

**T**he option ARM trend is only the most obvious example of shaky lending during the bubble. Some banks slackened their standards even when making Federal Housing Authority loans, which are insured by the government and must conform to strict rules. On Aug. 10, for example, the U.S. Housing & Urban Development Dept.'s Office of Inspector General found that National City Mortgage, a unit of National City Corp. in Cleveland, "did not fully meet HUD's requirements" on any of the nine loans the agency sampled randomly during a routine audit. HUD also said National City failed to follow up on iffy employment and credit information in all nine cases. In a statement provided to *BusinessWeek*, National City said it found errors in just seven loans. "This is an instance of a failure to meet our own stringent internal standards on a very small percentage of our production," it said, "and is certainly not indicative of a loosening of standards."

Others are seeing slackening as well. The U.S. Office of the Comptroller of the Currency has surveyed the underwriting practices of retail banks for 11 years. Last year it found a third of the largest banks had lowered their standards—a record. "Lenders have abandoned all standards in an effort to maintain short-term earnings," says Peter Schiff, president of Euro Pacific Capital Inc., an investment firm in Darien, Conn. "Now we have people in houses who have no prayer of making the payments or even selling their houses."

How bad have things



gotten? In 2005 banks gave 43% of first-time home buyers loans for fully 100% of their house value, says the National Association of Realtors. Until recently "these loans did not exist," says Walter Molodtsof, a NAR spokesman. The ultimate sign of lax lending: so-called no-doc loans, which don't require any documentation or the part of the borrower. Anything goes, it seems to keep the money flowing.

Consider Greg, a single father earning about \$45,000 a year as a baker in San Diego who asked *BusinessWeek* not to use his last name. A decade ago a bank might have given him a mortgage for about \$100,000, or 2.5 times his income, the rule of thumb. Yet he's on the hook for about \$940,000, or nearly 21 times his pay, with two loans on two houses from Countrywide and Accredited Home Services. (Neither would comment on an individual case.) Says his bankruptcy attorney, Ray Schimmel: "He got those loans in about a year. How crazy is that?"

Greg started by borrowing \$4,500 from his 401(k)—not even enough to the cover closing costs. When he couldn't make payments on his first house, he rented it out and moved into a utility closet. Then he tried to get out of trouble by buying another house and flipping it. No dice. To cover his three mortgage payments, he has racked up \$55,000 in credit card debt. Both houses are for sale, but in a slumping California market Greg will be lucky to break even.

### No Downpayment Necessary

Housing prices and home budgets are no longer constrained by a family's ability to save the once-required 20% downpayment.

### No Documentation, Either

Borrowers no longer have to demonstrate their ability to repay a loan with proof of employment, income, financial assets, and credit history. Without that hurdle to clear, homebuyers and mortgage brokers have an

incentive to fudge budgets.

### Exotic Mortgages

With a traditional 30-year, fixed-rate mortgage, borrowers must have the income to pay both interest and principal. Loans sold on their monthly minimum payments, such as interest-only loans, lure borrowers into debts they have difficulty repaying.

### Rising Debt-to-Income Levels

Mortgage payments, property taxes, and other

homeownership costs once added up to no more than a third of a homebuyer's income. Lenders now routinely allow such payments to consume as much as half of a borrower's income.

### The House as Piggy Bank

Overstretched homeowners are still pulling huge piles of cash out of their homes, either through refinancing or home equity loans. These days they're increasingly using the money to pay the mortgage, temporarily escaping foreclosure.

Data: Euro Pacific Capital Inc., *BusinessWeek*



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# Phantom Profits

**T**here's hardly a rival in mortgage lending that Countrywide Financial CEO Angelo Mozilo hasn't taken a swipe at. During a January earnings call he complained that Ameriquest Mortgage Co. and New Century Financial Corp., among others, were giving the industry a bad name with "irresponsible" grubbing for profits and lax standards. Then, in a July call, he lambasted Lehman Brothers Inc. and Bear Stearns Cos. as neophytes in underwriting and pricing home loans. "It tightens my cheeks," Mozilo said. "They don't know anything about the mortgage business."

It seems the CEO of America's No. 1 mortgage lender would have you believe the company is above reproach. But Calabasas (Calif.)-based Countrywide has been among the most aggressive underwriters of option ARMs. As of the end of last year, the dollar amount of option ARMs on its books leaped more than fivefold, to \$26.1 billion, or 38% of its total mortgages held, vs. 11% in 2004. Three-quarters of the company's option ARM borrowers chose the cheapest mortgage payment, according to its latest earnings release—meaning these loans could reset at much higher rates. Yet accounting rules let Countrywide book the full payment as revenue on its books right now.

That has boosted Countrywide's bottom line nicely. It reported \$295 million in deferred interest revenues for the 12 months ended June, 2006, vs. \$5.9 million in the previous 12 months. In the second quarter those revenues represented 19% of net interest income, up from virtually zero a year earlier.

Mozilo, 67, who declined requests to be interviewed, has seen his share of real estate

cycles, good and bad. But he might not have bargained for the aftermath of this latest housing bubble. "We don't see how he can be so confident," says David Hendler of CreditSights. "Later on you are going to see whether that earnings stream plays out."

In a written statement, Countrywide said the "PayOption ARM is a popular product and Countrywide takes steps to inform borrowers about the features and potential risks." The company also said in the statement that it had so far this year sent out 8,500 letters to customers "reminding them their future minimum monthly payment could increase if they continue to make the minimum monthly payments."

Early indications of the performance of Countrywide loans are troubling. Desmond Macauley, an analyst at RBS Greenwich Capital, found that of the option ARMs Countrywide originated in 2004, about 1.4% of borrowers were 60 days or more late on their payments by the loan's 24th month. For similar loans originated by Washington Mutual, the comparable number was 0.31%. Macauley noted that while the majority of borrowers are keeping up with their monthly payments so far, the results raised questions about whether Countrywide lowered standards to bolster business.

At a May conference hosted by Sanford C. Bernstein & Co., analyst Howard Mason asked about the risks of ARM portfolios in a downturn. "What might that do to your earnings?" queried Mason. Mozilo replied: "The impact on Countrywide through any of these cycles has been de minimus."

But despite the brave talk, Countrywide has begun to tone down its lending. On July 25 it reported that its option ARM volume had decreased 42% in July from a year earlier. That's vs. a 19% decrease in overall loan volume.



with the new option ARM. They say had no idea when they signed up, however, that the low payment adds \$60 of deferred interest to their balance each month. Worse, they thought the loans would last three years, but they're already paying 7.68%. "What reasonable human being would ever knowingly give up a 5.25% fixed-rate for what we're getting now?" says Eric, 36, who works in commercial construction. Refinancing is out because they can't afford the \$15,000 in fees. "I'm paying more, and the interest is just going up and up and up," says Jennifer, 34, a stay-at-home mom. "We feel like we got totally screwed." The mortgage broker has stopped answering their phone calls. Indymac declined to comment on the loans.

Stories like these can be found across the socioeconomic spectrum, says Al Fishbein, director of Housing & Community Policy for the Consumer Federation of America. In a May focus group, the group found that option ARM customers with lower income levels said the loans were the only way they could afford their homes. While many recognized that their payments could increase, "they professed complete surprise that they could increase as much as they could," says Fishbein. That lack of diligence will cost them over time.

Not that all option ARM holders blindly. While the loans are marketed aggressively, plenty of holders know exactly what they're getting into. Jon and Meghan Bachman of Portland, Ore., consider them wealth-building tools. "I want to own a bunch of houses,"

More borrowers are paying the minimum on their mortgages each month. Yet banks are still looking flush as they continue to book the full amount as revenues.

| BANK                     | NET DEFERRED INTEREST REVENUE          |                                        |                               |
|--------------------------|----------------------------------------|----------------------------------------|-------------------------------|
|                          | 12 MONTHS ENDING JUNE, 2005 (MILLIONS) | 12 MONTHS ENDING JUNE, 2006 (MILLIONS) | PERCENT CHANGE YEAR-OVER-YEAR |
| <b>COUNTRYWIDE</b>       | \$5.9                                  | \$294.8                                | 4,885%                        |
| <b>GOLDEN WEST</b>       | 133.0                                  | 754.5                                  | 467                           |
| <b>WASHINGTON MUTUAL</b> | 16.8                                   | 427.0                                  | 2,442                         |

Data: Banc of America Securities



## We want to own a bunch of houses. We're hoping for early retirement"

—Graphic artist Meghan Bachman and her husband, Jon, who owns a body-piercing shop, are using option ARMs to buy Portland (Ore.) properties on margin

an. "We're hoping for early retire-  
far they have stayed out of the fire. couple, who are in their 30s, bought first home, a 100-year-old farm in Portland, Ore., in October, with a no-money-down loan for \$100,000 from GreenPoint Mortgage, a unit of NorthFork Bancorporation Inc. The house, the value of the house had risen to \$275,000. Rather than sit tight and wait for their grandparents might have, the couple, with an annual household income of \$70,000, took out a home equity loan to put a \$30,000 downpayment on the investment property in an up-and-coming neighborhood nearby. They pay a premium of just \$825 on their new \$100,000 mortgage, and rent the house for \$100 more than that. Sooner or later, the payment will rise. Then they'll have to raise the rent to stay in the black. In the still-strong Portland housing market, they could find themselves in trouble. It's a risk they say they're willing to take. Public policy has yet to catch up with the new complexities of the lending industry. The Comptroller of the Currency John Dugan, the banking industry's main regulator, wants banks to clean up their act. A source inside the federal Office of

the Comptroller says Dugan intends to raise lending standards, as he did last year on credit cards, where super-low minimum payments made it improbable that cardholders would ever pay down debts. New guidelines are expected this fall.

Fair-housing pundits suggest that mortgage lenders follow the lead of the securities industry and require that mortgage borrowers be not only eligible for a product but also suitable—meaning the loan won't impose hardship. Says Consumer Federation of America's Fishbein: Buyers have to have a "reasonable prospect of being able to handle the payments, not at the initial rate, but [assuming] the worst-case scenario."

So far, banks have shown little desire to raise their standards. In February, Golden West announced it would raise its minimum option ARM payment to 2.6% of the loan. In March, Golden West's Sandler wrote a nine-page letter to the Office of Thrift Supervision decrying the lax lending standards he was seeing. "Foolish lenders who eventually stumble under the weight of their missteps will bring down innocent borrowers with them and leave the rest of us to clean up the mess," he wrote. But on May 7, Golden West announced it was selling out to Charlotte (N.C.)-based Wachovia Corp. By June it had dropped its option ARM rate back down to 1.50%. Sandler says the rates were changed according to the bank's interest rate outlook.

Analyst Frederick Cannon of Keefe Bruyette & Woods says most banks don't apologize for their option ARM businesses. "Almost without exception everyone says [the option ARM] is a great loan, it's plenty regulated, and don't bug us," he says. In an April letter to regulators, Cindy Manzettie, chief credit officer for Fifth Third Bank in Cincinnati, said it's not the "lender's responsibility to help the consumer determine the appropriate payment option each month.... Paternalistic regulations that underestimate the intelligence of the American public do not work." ■

# "THE FRENCH MAY BE EXPERTS ON FOOD AND WINE, BUT WHAT CAN THEY TEACH US ABOUT RUNNING A COMPANY?"

Armando Zagalo de Lima of Xerox appreciates the French taste for innovative management as much as he enjoys their taste for the good life.

### Trouble on the Home Front

**Listen In:** Hear a podcast interview with Banking Editor Mara Der Hovanesian by Executive Editor John A. Byrne.

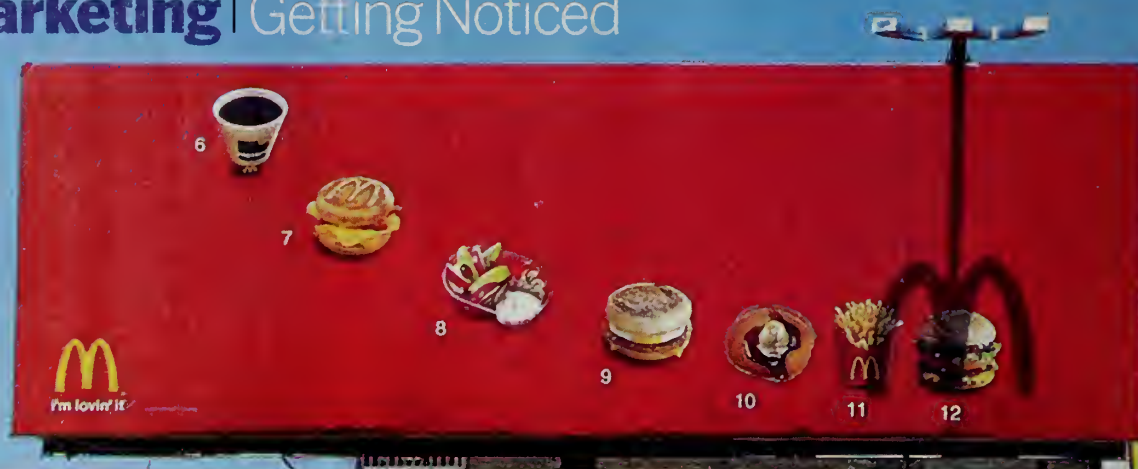
**The Biggest Players:** See how the busiest underwriters of option ARMs stack up.

**Slide Show:** Take a tour of the lending system and see how everyone but the homeowner profits.

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# Street Stunts on The Digital Highway

Marketers get lots of bang for the buck when gimmicks catch fire online

BY BURT HELM AND JOSEPH PISANI

**M**CDONALD'S CORP. wanted to rev up its breakfast business in Chicago. So it tried TV and radio spots and local newspaper ads. But guess what move gave the company's marketers the biggest bang for their buck? A single billboard in a parking lot across the street from Wrigley Field. The sign was a specially engineered sundial that highlighted different breakfast items with a golden arches shadow as the hours of the morning progressed.

Almost immediately after the billboard went up on July 11, it was a hot item online. Once Leo Burnett Worldwide Inc.'s public relations department placed a photo of it on [Chicagobusiness.com](http://Chicagobusiness.com), a regional trade site, the picture was sent all over the Internet. Soon blogs ranging from [adrrants.com](http://adrrants.com) to [gizmodo.com](http://gizmodo.com), which focuses on gadgets, were discussing it. In two weeks, the photo was visited 105,000 times on the [Chicagobusiness.com](http://Chicagobusiness.com) site alone.

These stunts are "like dressing yourself up in a clown outfit, handing out cameras, and then saying 'comment on me,'" says Rishad Tobaccowala, chief executive of Denuo, the media buying unit of Publicis Groupe specializing in new media.

Clearly, marketers are seeing this as the Golden Age of the street corner gimmick. With a clever idea and a few thousand dollars, brand managers are able to harness the power of blogs, video, and photo-sharing sites like YouTube and Flickr, thanks to the millions of people roaming the streets with camera phones. The result: Street stunts captured in pixels are becoming an engaging form of brand advertising online. From the sundial billboard to a manhole cover dressed up as a steaming cup of coffee to promote Folgers, such moves can create "greater exposure and commentary" than traditional media advertising, says Rob Jackson, director of marketing for McDonald's in the greater Chicago region. "The [PR] return on investment is extraordinary."

## THE ONLINE ADVANTAGE

THE STUNT'S life in terra firma is often far more fleeting than its life online. When Procter & Gamble Co. hired Saatchi & Saatchi Worldwide Inc. to promote its Folgers brand last March, the agency came up with the idea of placing a vinyl cover over a steam-spewing manhole in New York City, making it look as if there were a piping-hot cup of coffee embedded in the street. Although the one coffee cover was only in place for a few hours, photos of it ricocheted around advertising and New York-themed blogs,

eventually scoring an appearance in the *New York Post* in May. "It works better as a photo," admits Folgers brand manager Ed Bello, especially since team couldn't get permission from York for any larger-scale plan (the from a manhole isn't appetizing, either). The McDonald's sundial has similar problems in the physical world. It actually works for six hours, and the engineering requirements to light it make a widespread rollout unfeasible.

Just the same, life online can be hard to control. Court TV learned that lesson when it decided to link mysterious billboards in New York and Los Angeles in August with a fictitious blog to promote the show *Paro, P.I.* The billboards were made to look as though they were being chased by a crazed wife, Emily, who accused her cheating husband. Court TV marketing manager Marc Juris says the move was to pique people's curiosity for weeks before Court TV revealed the billboards were connected to the show. For those who searched online, they found a blog, ostensibly written by a wrathful wife.

But Net surfers were too fast: curious bloggers discovered Court TV's behind the blog within three days of the billboards going up. With its exposure blown, the channel had to rapidly retool how to manage the two weeks before the show's premiere, and rejigger the blog and ads that assumed the trick would remain secret. It was a lot of unexpected scrambling, but Juris was not disappointed. Court TV got more than 2 million hits to the Emily blog from 600,000 different users. Juris says Court TV should have had an inkling about the speed at which folks would respond. "Right as the board on Houston Street [in New York] was going up," says Juris, "the chief director saw a guy standing next to it with a video camera saying 'wow!'"

## GOLDEN

McDonald's sundial appeals to drivers and surfers alike

European President  
Armando Zagalo de Lima  
says Xerox can rely on  
the French for innovative  
business practices.

You're in charge of Xerox across Europe.  
How does France fit into the picture?

Xerox France has consistently been one of our best  
performance units. It's been that way for a very long time.

What's the secret behind that success?

Strong leadership. There's always a link between  
senior leadership and success. Over the past 15 years,  
at least four of Xerox's heads of Europe have been  
French. They've instituted some highly innovative  
management practices and they've been extremely  
successful with them.

What sort of new thinking has your  
French unit come up with?

To give you just one example, there's the concept of  
concessionaires. That's a French word, by the way.  
It means we have a third-party company selling only  
Xerox solutions in exclusivity. It's a familiar idea in the  
retail industry, but very original in our business. When  
our French unit came up with the concept 25 years ago,  
the rest of the company was extremely skeptical. But the  
French proved it could work and make money. It's now  
become a business model for Xerox all over the world.

## Xerox in France

Over 4,000 employees

Over 140 concessionaires

and more than 300 distributors

Grenoble research facility

one of the four main Xerox

innovation centers around

the world

creativity. The French have that capacity to dream up a  
vision, build a plan to achieve it, then execute it.

What are they like to deal with?

The French have been very responsive to past criticism  
and are much more willing to conduct business in English.  
French executives are very open and enjoy working face  
to face. They like people to come and say: 'If there's  
a problem, call me and I'll be here'. And they're loyal.

How would  
you sum up  
the French?

Creative, very  
open to doing  
things differently,  
to going after  
a big idea and  
thinking 'out of  
the box'. France  
is a place where  
wild ideas can  
actually become



"France is a place  
where wild ideas  
can actually become  
reality. The French  
have that capacity to  
dream up a vision,  
build a plan to achieve  
it, then execute it."

A French customer will stay committed to his supplier. I've  
always had the feeling I could rely on the French.

Everyone knows what Xerox means.  
What does France stand for?

It's one of the world's great cathedrals of good taste.  
It's art, it's fashion, it's design, it's food and wine.  
And it's business too. You go to a lot of countries and  
you say, "I could do business here, but I'm not sure  
I want to live here." You don't say that in France.  
France is a place where you can do business and still  
appreciate the good things in life.

Now is the time to invest in France.  
To find out how the Invest in France Agency  
has helped some of the world's leading  
companies and what they can do for you,  
visit [www.thenewfrance.com](http://www.thenewfrance.com)



**9/11** Five Years Later

# A Tale of Renewal

BY TOM BARRASH

For the 9/11 survivors of Cantor Fitzgerald, working to rebuild their firm has been the key to healing

Cantor survivors (left to right)  
Chris Crosby, Matt Claus,  
Howard Lutnick, Heidi Olson,  
Paul Pion, Joe Noviello

PHOTOGRAPH BY LEN IRISH





SEPTEMBER 11, 2001

Every one of the 658 Cantor Fitzgerald employees at desks in the North Tower morning perished. The single loss by any comp

credits those whose were spared and stayed Cantor. "The normal co of events is you have a c and you go for weeks so it out. But in the fall of : we'd have a crisis at and another at eleven then another at one were in crisis mode for cally a year."

Survivors are quick share stories of 90-weeks, of adrenaline-f

problem-solving, and of an unshakable belief in one an Work was not just a distraction; most say it healed them.

As the country reflects again on the meaning of the eve September 11, 2001, and as politicians invoke the day in paign ads and stump speeches, the story of Cantor Fitzg has morphed from one of unfathomable loss to one of in ity, perseverance, and finding meaning through work.

Cantor people are starting to take vacations and refle their good fortune. Still the anniversary fills many of them dread because no matter how far they've come, they v asked to tell their 9/11 story again. Where were they? Wl they live? How did they feel? And they're simply tired of ing that day one more time. It just might b the Americans most able to move on fro events of September 11 are the men and wor Cantor Fitzgerald who lived through them.

**O**n a recent Tuesday evening after worl Cantor colleagues meet for drinks at Carney's, a saloon two blocks from the. Maryann Burns, Lutnick's administrative as on 9/11, missed her train that morning and a after the devastation had begun. Heidi Olson chief administrative officer for equities, h Cantor when the firm downsized just before tacks; she came back to work the next day Crosby and Jim Johnson are both members technology team at eSpeed, Cantor's ele bond-trading system. Crosby was setting o fishing trip when the Twin Towers were hit son was working in Cantor's London office.

The conversation is about the Ground Ze memorial service and whether people will atte about Oliver Stone's film *World Trade* which no one intends to see. "Why would ject myself to that," says Olson. Crosby s might see *World Trade Center* on DVD so but not in a room full of people he doesn't

For a long time, Crosby and Burns agree tough to talk with anyone outside of Cantor what they'd been through. "The only place felt like myself was work," says Burns. "I ne be around other people who'd been where I'd

## "WE ALWAYS THOUGHT WE'D FALL APART AT SOME POINT,"

Howard Lutnick is saying two weeks before the fifth anniversary of the terror attacks that decimated Cantor Fitzgerald and took his brother's life. "I'd tell people it was like I was surfing in front of a very large wave and as long as I kept going forward as fast as I possibly could, the wave would never get me. But if I ever stopped, and took a moment to look back...." He turns to look at an imaginary wave. "Whoosh, the wave would crash over me, and I'd get crushed. But if I kept moving forward, the wave would get smaller and smaller, and that's what happened."

Lutnick's temporary office is on 59th and Lexington in Manhattan, near Bloomingdale's. For a CEO, the view is pedestrian at best. At eye level is a corporate gym in the office building across the street, where a few white collars are sweating away on stationary bikes. It's a far cry from the spectacular vistas at the World Trade Center, where Cantor Fitzgerald occupied Floors 101 through 105 in Tower One. But since September 11, Lutnick has insisted on low floors. Behind his desk are pictures of his brother, Gary; his best friend and right-hand man, Doug Gardner; and his fellow board members, Fred Varacchi and Joe Shea—all of whom died in the attack.

**F**or five years, Lutnick and his brokerage firm have been fighting back from the horror and heartache of 9/11. The worst terror attacks in America's history killed every one of the 658 Cantor Fitzgerald brokers, traders, technology specialists, and secretaries who were at their desks that morning. It was the single greatest loss suffered by any company or organization. After three moves and

countless business crises, the firm's future is secure again, and it now has more employees than before the attacks.

Lutnick, who lived because he was taking his son to his first day of kindergarten, calls the recovery "miraculous" and



**"We stood at hell's doors, and we held the line. It doesn't matter what you throw at us. [Our people] will hold their line."**

—Howard Lutnick

Tom Barbash is the author of the 2003 best-seller *On Top of the World*, the story of the devastation at Cantor Fitzgerald

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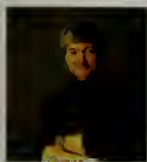
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## GROUND ZERO

In the aftermath of the attack, surviving Cantor employees found relief in adrenaline-fueled 90-hour weeks

then I was going through habilitation. So I never had the chance to deal with a group way, day in and day out. What I dealt with was the personal impact of the attack.

Now Waizer's daughter is heading to college. At 55, he looks 10 years younger. The burns are barely visible. But he says one of the procedures he underwent was the equivalent of a skin tuck and jokes that looking younger is a side benefit.

didn't want to have to explain myself. In groups of other people I often felt detached, you know? Distracted." Work, Crosby says, "made me feel sane. I wanted to go into work every day. I still do."

All of them tell stories of changing the channel or leaving a room when 9/11 gets brought up. Sometimes it feels as if there's no escape. (On our way out of the bar, we pass a man seated on a folding chair wearing a hard hat on which sits a tin foil model of the Trade Center. Burns says: "I rest my case.")

"And yet," Crosby says, "there are times when I'll be out to dinner with my wife and I'll hear someone talking about 9/11 and getting it wrong, and I'll feel the need to go over and correct them."

"You tell them where you work, and they give you that look," Burns says making a sad, sympathetic face, and the others nod in recognition.

They all know the look.

**H**arry Waizer, Cantor's tax specialist, was out to dinner recently with his wife, Karen, and someone he hadn't met before. "It came out that I'd been in the building on 9/11, and I got the look," Waizer tells me the next day in his office.

"She asked if I minded telling my story and for the first time ever, I turned to Karen and said, 'Why don't you tell it?' I've thought about why I did that. For one thing, my children were there. I don't think I've ever told the story of that day to my children. But I also think it was part of... just putting it behind you. I went through a period in which I told the story multiple times because everyone who visited wanted to hear it. But that has stopped. I don't particularly want to go back to that time."

Waizer was in an elevator high in the North Tower when the plane struck. Flames ignited inside the car and he was badly burned on his body and face and in his throat. Now he's back at the firm working three days a week for General Counsel Stephen Merkel's legal team. He says he wishes he'd been with his colleagues from day one.

"While they were burning the midnight oil, I was, for two months, lying in an induced coma, and for months more I was in a hospital bed, and

skin tuck and jokes that looking younger is a side benefit.

What triggers his memory of The Day? "It isn't fire that I remember," he says. "It's elevators. For a very long time, I couldn't get on an elevator without thinking back, and every time something out of the ordinary happens on an elevator, I get it back. Say it comes to an imperfect stop. It'll just rock a little. Nothing that would make a person nervous, but for me it's a reminder."

**S**tephen Merkel was on a different elevator on the 11th floor when the plane hit. Merkel was physically unharmed but recognizes how close he came to a different outcome. "What I learned was that I had the capacity to shut down emotionally and just get on with it, and that might not be the best trait for a husband, a father, or a friend, but for what we were doing, it was necessary."

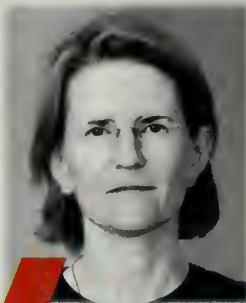
Merkel says the anniversary is something that his friends simply want to get through. Talking about The Day, he says, is neither as hard as it used to be.

"What's lost from then is the intensity. I can't easily describe it, whether it's the fear or the grief... all those feelings that were so powerful then are less so now, which I'm grateful for. Recall was at the site. I had to walk over the overpass and used to walk on, and everyone was rushing their trains, and I felt a tinge of what I felt then, like a switch that was turned on."

**F**rank Walczak felt that same switch turn on when he took his children to see *Pirates of the Caribbean*.

"Kids' movie, right? Pretty harmless stuff. Then while we're sitting through the preview, they show the one for that Trade Center movie. Instantly I got taken back there. I felt distraught. I started crying."

Walczak, a life-long surfer, had taken the day off on September 11 to catch the swells kicked up by Hurricane Erin. Sitting on his board in the surf off Sandy Hook, just south of the city in New Jersey, Walczak saw smoke pouring out of the Trade Center.



**“We spent a long time in a very scary, vulnerable place. And we worked together through it. Of course there’s a closeness.”**

—Heidi Olson



An abstract graphic featuring a complex network of glowing blue and white lines, resembling fiber optic cables or neural connections, set against a dark background. The lines are interconnected, forming a dense web that fills the upper portion of the page.

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## RECOVERY

Lutnick on the busy trading floor at the company's temporary headquarters in midtown Manhattan

In the firm's post 9/11 realignment, Kravette was forced, like Walczak, to switch jobs and become an equities trader after a dozen years trading bonds. He's progressed quickly and is more successful than he's ever been, he says.

For a year after the attack, Kravette says he woke up often in the night, short of breath and full of anxiety. He saw a therapist for a few weeks but then stopped because he said the therapist wasn't helping. "The only thing that helped was work, really."

ter. He began calling the office and the homes of his colleagues. No one else on the foreign exchange desk where he worked survived. Walczak had to reinvent himself as an equities trader.

"I still feel a tremendous sense of loss. You start to think of how much time you spent with these people. More time than with your own family," Walczak says he has been able to honor his friends through work. "I needed to do this. I can't imagine going somewhere else. I feel like what we're doing comes from within. We're rebuilding the company and rebuilding ourselves. It gives you a sense of completion."

The bombings in London last year and the recent discovery of a 9/11 style plot "sent a shock through my body," he says. "We were planning a trip to London, and we just canceled it."

Overall, though, he feels happy. He now works in Cantor's Shrewsbury (N.J.) office, eight minutes away from home. He can surf nearly every summer evening if he wants.

"I had a lot of guilt with this. I still get the feeling that people look at me and think, 'Why weren't you there?' But in general I'm doing much better. I know I'm here because of luck, because I surf, and because there was a hurricane. But I'm going to make the best of my life, because I know I can't take anything for granted."

"I've told the story so many times I can recite it in my sleep," says Cantor Partner David Kravette, a childhood friend of Lutnick and one of only two Cantor survivors who had been in the office that morning and left before the plane hit. Kravette is speaking from a vacation house in Jackson Hole, Wyo. "The new guys will ask me for my story, and I sort of give them the Cliff's Notes version."

Kravette's story is not an easy one to forget. He lived because a customer had forgotten his photo ID and Kravette needed to clear him through lobby security. He had considered sending his secretary but decided to go himself because she was seven and a half months pregnant. After the initial explosion, he saw an elevator free-fall to the ground and a fireball of jet fuel rage through the lobby straight at him before "it just stopped and sucked back in on itself."

He said he thinks often about the friends he lost and he's been unable to maintain a close relationship with the families of those friends. "I started to think I was making them feel pressed and uncomfortable, you know? They'd answer the phone in a happy voice, and they'd hear my voice, and then there'd be a few seconds of silence. I guess I gave them bad memories. That's what I felt, like an old boyfriend calling. At some point, I just stopped."

Harry Waizer says he felt the same awkwardness when he reached out. "You could hear the walls go up when you spoke to people. But you had to understand it, because they were being protective and they were protecting themselves. And why would one want to open themselves up to more pain?"

"Each year, September comes and you start to feel a little weird," says Joe Noviello, chief product architect at eSpeed. "You feel it coming. The days are beautiful, but Summer's coming to a close."

Noviello, Crosby, Matt Claus, and two others survived because they were preparing to take a fishing trip. When they heard about the attack, they convened at Cantor's disaster recovery site in Rochelle Park, N.J. (built after the 1993 World Trade Center attack), and began the Herculean task of restoring Cantor's bond trading system.

While he was working around the clock, Noviello was also preparing for his wedding, which was scheduled for Sept. 29. Joe and his fiancée, Lynley, considered changing the date, but many of the guests had died, but Noviello is proud they went through with it. It gives him a special association with September. "Instead of thinking about the attacks, it's my wedding month."

Did he seek out help after September 11? "I didn't talk to anyone about it. I didn't see a therapist or counselor. I think I just dealt with it through my work. Working through this together and watching each other rise to the occasion, that helped. And then you'd think of one of the guys who died and it would just whack you." Like Lutnick, Noviello keeps photos of friends who perished around his office. "I just like having them around me," he says.



**[Work] made me feel sane. I wanted to go into work every day. I still do."**

—Chris Crosby





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## GROUND ZERO NOW

For many at Cantor, the anniversary is something they simply want to get through

**A**n hour before she hits the Broadway stage in *The Color Purple*, LaChanze Fordjour, whose husband, Calvin Gooding, died in the attacks, meets me at Maison, a French bistro where she often eats before performances. LaChanze, who won the Tony Award this year for best actress, says she's continually amazed at where life has taken her since the attacks that stole Calvin, her husband and my college friend.

Like the traders, LaChanze says work is what has kept her sane and restored her happiness. "I can't imagine my life with Calvin now because I'm married to someone else," she said. "But I wish he was here. I miss him."

LaChanze was in her ninth month of pregnancy on September 11. She was one of thirty-eight wives of Cantor Fitzgerald victims who were pregnant. I visited her in the hospital shortly after the attacks. She told me then she could never imagine remarrying. She was irritated with those who suggested that she would someday move on.

The December after the attacks, Eve Ensler, author of *The Vagina Monologues*, who'd heard about LaChanze's loss, called her and told her she needed to get out of the house and start working. Ensler knew LaChanze only through her work but gave her a role reading the play for a three-week run at an Off-Broadway theater near Times Square. It changed everything, LaChanze says.

"I really was spiraling down," she says. "I was an unemployed actress with two children, a husband who had died. My prospects were slim. I got that job, and I saw that I could be productive. That I had things I could bring to people."

She says her children were instrumental in her healing. "I call them my earth angels because they forced me out of myself. It was important to be able to take care of someone else."

She said she thinks of Calvin every day when she puts her children to bed. Her older daughter, six-year-old Celia, shares Calvin's features and his boisterous personality. Zaya is more introspective, though just as smart. "She's four and reading at a second-grade level," her mother says.

Two years ago she met the artist Derek Ford-

jour when she commissioned one of his paintings as a gift for an attorney who had handled her post-9/11 lawsuits pro bono. They married in the summer of 2006.

LaChanze says she's living off of September 11 memories. She has been to the site each year and will sing at this year's event in Central Park. "You know what it's like. Think of losing someone you love. Now imagine going to a funeral for them every year for five years. It's hard. I don't want to go back there and over again," she says.

**"F**or a good six months my life was a black hole," says Marber, the popular head of Cantor Fitzgerald Equities. "For a long time I couldn't really figure out why I was there with everybody else. And then you ask, what's my purpose in life? Things like that. All I wanted was to get the company back to where it was, to the level we were at in 2000."

Marber says he can't imagine what life would be like if the firm had gone under. He has too much of himself invested in it. Now that his division is doing better than ever, he's beginning

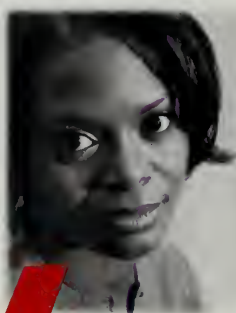
to let himself relax and spend more time with his two teenage daughters. And he takes great comfort in the fact that the firm has paid out more than \$180 million of its profits to the families. "I've survived, and we've lived up to our promises. I feel very good about that."

**L**ike his colleagues, Howard Lutnick recognizes that work has kept him from dwelling on the devastation and from slipping into a prolonged depression.

"I used to get very sad and reflective when I was alone in the car or alone in the dark. As time went on, it happened less, and I just stopped crying. Just this past weekend, I was at a party. I met one of the firefighters. He told me how he'd been at the scene that day and then we told each other stories with much more color and granularity and clarity than we would normally tell them with. Because we'd both lived through it. I could see everything as we talked, and that makes me know that it's all still very present in me. It just doesn't come out in front of everyone."

While he values time with his wife and children, he says he now equally cherishes his time with the other Cantor survivors.

"We stood at hell's doors, and we held them. It doesn't matter what you throw at us. [Our people] will hold their line, and I'll hold mine. It's much more personal now." ■



**“Think of losing someone you love. Now imagine going to a funeral for them every year for five years. It's hard.”**

—LaChanze Fordjour



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# The Greenest House on the Planet

Steve Glenn's LivingHomes sets a new standard in eco-friendly homebuilding

BY CHRISTOPHER PALMERI

**I**t waters itself. It powers itself. If only it could take out the trash. Entrepreneur Steve Glenn's ultra-energy-efficient house in Santa Monica, Calif., is the first home in the country to be given "platinum" status in the U.S. Green Building Council's influential LEED rating system (for Leadership in Energy and Environmental Design). Glenn, the founder of Web software firm PeopleLink Inc., worked for more than two years on the project, hiring Los Angeles architect Ray Kappe to lend his earthy blend of California modernism to the design.

For Glenn, the two-story, four-bedroom structure (about 2,500 square feet) is more than just a place to live. It's the prototype for his new business, LivingHomes, which sells prefabricated houses based on his model for about \$250 per square foot. That price doesn't include land, site preparation, or transportation of the components, which brought the total cost of Glenn's home to more than \$1 million. The bulk of the house was built at a factory in Santa Fe Springs, Calif., and assembled in one day. A high-speed video of the installation can be seen at the company's Web site: [www.livinghomes.us](http://www.livinghomes.us).

Glenn says the eco-friendly features added about 20% to the base cost of the home. Even by saving an estimated \$1,500 a year on utility bills, he won't make up the difference anytime soon. But for Glenn, the point is to live in a home that causes the least damage to the environment. Living healthy also counts, so the paint he selected gives off next to no volatile organic compounds, and the largely steel and concrete construction inhibits mold and termites. "We're targeting consumers who buy organic food, do yoga, and shop at Design Within Reach," he says. ■

**GREEN  
BiZ**

**HOT WATER** A panel of glass tubes, manufactured by Apricus Solar, is positioned on the roof. Water pumped through the tubes is heated by the sun and stored in an insulated tank for use in showers and sinks. Hot water is also circulated through a series of plastic tubes embedded in the house's floors. This radiant heating system is more energy-efficient than forced air and doesn't spread pollen, dust, germs. It also keeps your toes toasty. Cost: about \$33,000

**VENTILATION** A "whole house" ceiling fan from Tamarack Technologies pushes hot air out of the home. Of course, living by the beach doesn't hurt—Glenn's house doesn't need air conditioning. Cost: \$1,200.



**FIREPLACE** The EcoSmart fireplace denatured alcohol special receptacle it produces minimal and other waste gas doesn't need a flue chimney in the living room. It actually houses electrical wires and plumbing.



**CLEARED WATER** Rainwater is collected from the roof and is stored in a cistern located under the house. So-called "gray water" from the kitchen and showers is run through an underground filtration system consisting of sand, gravel, and soil. Both are used to water the rooftop garden and grounds. Cost: \$20,000.



**LIVING ROOF** A garden of deer grass and other native plants will help insulate the house, keeping it cooler in the summer and retaining heat in the winter. Designed by Great Outdoors Landscaping, the living roof cost \$8,000.

**ELECTRICITY** On sunny days, a photovoltaic panel from Schott Corp. puts out 2.4 kilowatts of power—up to 80% of the house's needs. Owners can sell any surplus energy back to the utility. The system cost \$12,000 after \$13,000 in state rebates and federal tax credits.

**LIGHTING** Bars of bright light-emitting diodes from American Permalight, used throughout the house, require one-tenth the power of incandescent bulbs. Cost: \$95 per bar.

**WINDOWS** Double-pane glass from Pilkington Group and sliding doors by Fleetwood Windows and Doors help conserve energy. Glass walls let in more natural light, cutting electric bills. Cost: \$33,000 for the entire house.





# The Green Stamp Of Approval

Architects and their clients are scrambling to win eco-friendly certification

BY CHRISTOPHER PALMERI

**T**HE MAKERS OF THE Prius hybrid car are big on green buildings, too. At Toyota's U.S. headquarters in Torrance, Calif., "no-flush" urinals and rainwater recycling help cut freshwater consumption by 94% compared with a conventional design. The company's new "salmon-safe" distribution center in Portland, Ore., filters water running off its parking lot, preventing oil from seeping into the Willamette River. And on Aug. 29, Toyota opened its first green dealership in suburban Dallas. On the building's west side, a "green wall" covered with Japanese Ivy keeps offices cool by soaking up the hot afternoon sun.

All three facilities have either won or applied for certification by the U.S. Green

Building Council, a 13-year-old nonprofit that has become the ultimate arbiter of eco-friendly construction. The Washington (D.C.) outfit has more than 6,000 members, from one-man architectural studios to corporate giants such as Wal-Mart Inc. Over the past six years it has administered the LEED (Leadership in Energy & Environmental Design) rating system for the greenest of buildings, 560 of which have qualified.

It's a sign of how far the council has come that architects now compete for clients by listing how many LEED-rated buildings they've designed. The group figures that 5% of all current nonresidential building construction in the country—some \$10 billion worth—is seeking certification. "This movement has created a whole new stream of economic development," says council co-founder and

**GENZYME HEAD OFFICE**  
Workers are sick less often than at other company facilities

CEO S. R. Fedrizzi. "at a ti point."

The building are a hit with companies and employees alike. Biotech company Genzyme's \$140-million headquarters in Cambridge, Mass., features 18 indoor garden and adjustable thermostats in every room and mirrors on the roof that reflect light into the atrium. The company's sick time among employees is 5% less than at its other facilities in the state, and 58% of staff report they are more productive in the building.

## COSTLY PROCESS

LEED certification is based on a 69-point checklist. Installing bike racks for employees who pedal to work produces one point. On-site solar generation can score up to three points, depending on how much clean electricity is produced. Once scored, a building can win one of four awards: certified, silver, gold, and the greenest design award, platinum. The points system intensifies the competition between designers. Rives Taylor, an architect with the Gensler firm, says: "Everybody wants to build the greenest high-rise or the greenest retailer."

Not everyone loves the process, though. Auden Schendler, director of environmental affairs for Aspen Skiing Co., co-wrote a widely circulated critique of the program last year. He complains the LEED process is too costly, too bureaucratic, and doesn't always reward the best environmental options. Final approval requires computer modeling of a building's energy use and recommendations, a side business for architects and consultants that can add \$50,000 to the cost of a 10,000-sq-ft building, according to Schendler's critique. Fedrizzi says the council is addressing such complaints: It introduced an electronic document filing system this year to streamline the process.

LEED won't ever be foolproof. As technologies and building types change, the standard evolves. Adobe Systems Inc. is seeking certification for three of its office towers in downtown San Jose, Calif., under a program that allows retrofitted buildings. Yet despite high-tech green systems, such as a lawn sprinkler system that takes input from weather forecasts, Adobe started to cut power during a recent heat wave. Then it hit on the perfect solution: Employees lowered the blinds. ■

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# Going Big By Going Digital

By adding extra channels, ION Media hopes to make the most of the transition from analog TV

BY CATHERINE YANG

**T**HESE DAYS, FORMER NBC Universal executive Brandon Burgess spends weekends grumpily setting up mosquito traps in his backyard in quiet West Palm Beach, Fla., instead of hobnobbing with other young media titans at SoHo wine bars. Last November, Burgess, 38, packed up his office at Rockefeller Center, where he spearheaded NBC's big merger with Universal Entertainment, to become CEO of lackluster Paxson Communications, an independent TV broadcaster just north of Miami. Burgess made the strange journey to the ends of the media universe to prove that the arrival of digital technology can turn even a mangy network into a thoroughbred. "In the analog world, we're a modest player," he says. "In the digital world, we have more airwaves than any other broadcaster."

Burgess, a buttoned-down Wharton grad raised in Germany, isn't entirely crazy for taking charge of a network known mostly for reruns of *Touched by an Angel* and other bland family fare favored by former CEO Lowell Paxson. The company, now renamed ION Media Networks Inc., is the largest TV broadcaster you've never heard of, with 60 stations reaching 91 million homes on coveted channels low on the dial. (By contrast, Fox TV, which owns the most stations among the Big Four Networks, has only 35.)

In Burgess's eyes, ION's big break will come when all local TV stations must switch from broadcasting shows in analog to digital signals by 2009 under law. So far the young CEO is in the broadcasting vanguard with a different idea of how to use digital technology. Many stations today already air some shows in

high-definition digital formats, or HDTV, and plan to do more of the same come 2009. Burgess, though, sees another path for ION. Instead of using digital technology to beam one channel with extra-sharp pictures, he wants each of his stations to broadcast two or three channels apiece at standard resolution. That leaves room to deliver other services, such as TV shows to cell phones.

## LIMITED RESOURCES

ION HAS ANNOUNCED the launch of two new digital channels for kids and for health programs. With its reach, ION gives the channels an overnight national springboard when launching shows independent of big cable or broadcast networks is nearly impossible.

Perhaps Burgess is more willing than other TV station leaders to embrace the range of digital possibilities because he has few other options. Unlike many TV stations with healthy cash flows, ION faces continuing losses and \$2.4 billion in debt. For ION, offering multiple digital channels is a new way to win audience and advertisers. And even as it acts out of desperation, "ION could be an example of what others choose to do down the road digitally," says Nancy Peretsman, managing director at media investment firm Allen & Co., which is helping ION scout for shows.

Yet moving an ailing

network beyond a blueprint to the thing is a challenge that board strategist Burgess has never had on his shoulder before. For starters, with its load racked up after a station buyout spree in the last decade, ION has few resources to create the hit shows it needs to gain audience for both its analog and digital programming. So Burgess is in constant motion. A weekly schedule includes meeting with Samsung in New York about cell phone chips for broadcast signals, before jetting off to Washington to chat with pals at the Federal Communications Commission. Then it's back to New York to dine with Sirius Satellite radio CEO Mel Karmazin as they exchange new ideas for the two companies.

Adding to the pressure, Burgess's former bosses at NBCU, a major stakeholder in ION, are watching. The new CEO concedes that begging for dollars has been a "life-shaping experience," in contrast with his previous life where he had "to find ways to spend money." But as a champion archer trained to stay on target, he says, "the situation affords frustration and despair." If he succeeds, NBCU will have won what many believed was a longshot bet the first invested in Paxson.

Still, to maintain arm's length from NBCU, Burgess says he now avoids befriending his mentor, NBCU Chairman Wright. Instead, he has surrounded

## Redefining Television

The former Paxson Communications, now called ION, is out front with programming plans for digital broadcast TV. Federal laws require that TV stations air shows using digital signals and end their analog broadcasts altogether by 2009. Digital technology will allow a station to deliver as many as six different channels. Here's how CEO Brandon Burgess plans to remake his company for the new age:

### PIONEER NETWORK

The launch of two digital broadcast channels (for kids) and a health channel helps ION leverage its 60-station national network in the digital world by multiplying program offerings and consumer-focused shows.

### BABAR Kids' club





with a group of independent advisers, including media consultant and onetime NBC executive Tom Wolzien. New York designer Schlossberg (Caroline Kennedy's husband). They are helping to implement strategy and update the company's culture. Schlossberg, for one, saw the name change to ION and a power-case logo to replace the Paxson shield, featuring him. Burgess also led up the lobby by a black leather and modern art.

The company's old hierarchical culture is starting to loosen up. A week before the news arrived, senior executives were bragging when they saw their names being scrubbed from personalized parking signs and replaced by numbers one to five. They were sure pink slips were soon to come. Today, the managers are all still in space No. 1. Instead, he raffles the spot to employees to boost morale.

With meager means,



## BIG PLANS

CEO Burgess wants to leverage ION's digital bandwidth

Burgess and team have had to work creatively. In many cases, they're persuading partners to foot the bill for producing programs in exchange for coveted distribution. In May, big names in kids' media—Scholastic, Canada's Corus Entertainment, and Classic Media—agreed to create a digital children's channel named qubo to run not only on ION but also on NBC and

NBC's Telemundo. Later that month, ION announced the I-Health digital channel, which will air educational programs. Now, ION is trying to attract independent producers who want access to the network. "There are no other broadcast facilities with this kind of reach at the times that we want," says John Lack, a creator of MTV, who is developing programming plans for ION. Other Burgess ideas: at the World Economic Forum in Davos this year, he mused with Google Inc.'s Sergey Brin about a TV program from an online hit. Google Earth on TV, anyone?

Burgess believes ION's digital channels, targeting underserved genres such as values-oriented kids' and educational health programs, have enough fresh appeal to win new ad revenues and a place among the clutter of TV channels, even if cable and satellite operators aren't currently required to deliver such digital broadcasts. While others may scoff at his optimism, ION has little choice but to think harder about its digital choices. "The other TV broadcast companies don't have to reinvent themselves as we do," says Burgess. Indeed, if the industry's ugly duckling survives the odds, other broadcasters may soon see the range of possibilities for digital TV, too. ■

## CATCH THE NEXT WAVE

How about using extra new digital spectrum to deliver dozens of audio stations to TV viewers, much like satellite radio, or TV shows to cell phones over the airwaves? ION sees these as potential new businesses.

## OLD TV

ing analog shows to programming. In concert with the Bros. and Sony their classics, from *Arrested* (above) to *Bram Stoker's Dracula* will replace the fashioned family *Touched by an Angel*. Lowering the price of viewers even by a price flagging ad sales and conversion.



Data: ION, BusinessWeek

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**FOUR MINUTES** of chat allow writer Jena McGregor (right) time to size up promising connections—and make a quick exit from dud

## Speed Dating For Suits

Based on the popular courting concept, speed networking aims to supersize your contacts

**BY JENA MCGREGOR**

**M**ET ARNOLD FIRST. A BEARDED redhead with rimless glasses, he sat down across from me, nearly knee to knee, and handed me his business card. Arnold is a director at a commercial real estate firm and specializes in office and showroom leasing. Hmm. No story here. (Clang!) Next up was Allan, a friendly, casually dressed guy who had worked with the former parent company of the Knitting Factory, a music venue in New York. Allan, who now runs an entertainment marketing firm and a career coaching service, had potential, but before I could learn more, the bell rang again. (Clang!)

Allan was followed by Scott, a “certified hypnotist” who wanted to show me a stress-reduction technique (Clang!); Ron, a quiet freelance writer with a wave of salt-and-pepper hair (Clang!); and Marvin, a sixtyish, straight-from-central-casting huckster who wanted to sell me on some kind of Web 2.0 affiliate scheme (“Video blogging! Video social networking!”) more than hear about me. “This is going to revolutionize the Internet—PERIOD,” he blared. (Clang!!!)

Although it may bear a striking resemblance, speed dating this was not. I was

participating in an evening of “speed networking”—a structured series of four-minute conversations modeled after the dating format. My goal? To write about this increasingly popular phenomenon, of course, but also I hoped to meet interesting entrepreneurs who might be worthy of a story.

While I had no success with my latter aim, the format—hypnotists and hucksters aside—has its advantages. Speed networking offers the glad-handers an easy chance to swap business cards and wallflowers a safe way to stop guarding the cheese platter. And for those of us uneasy with using “network” as a verb, it promises a gracious escape hatch from aggressive pitchmen like Marvin.

### GAINING MOMENTUM

SPEED NETWORKING has its roots in the 2002-03 downturn, but has proliferated recently. The folks who sponsored the event I attended, New York-based Networking for Professionals, are expanding to five more cities in the next year: Chicago, Phoenix, Los Angeles, Miami, and San Francisco. And now companies such as Deloitte Touche Tohmatsu and Chubb Corp. are organizing internal speed networking events.

Chubb first tried the approach in January to spice up a women’s group luncheon on networking. A few Deloitte offices have also begun using speed networking; the Dallas office holds occasional “speed mixers” in lieu of traditional cocktail hours to help young associates at the firm meet its always-traveling senior partners.

Local chambers of commerce, industry conferences, and professional groups are getting in on the act, too. Financial Women’s Assn. held its first speed networking event in June in New York. It was greeted with rave reviews, says Janet Handal, who co-chairs FWA’s lifestyles committee. Handal got the idea after hearing about speed dating from her yoga teacher, from whom she borrowed a 22-inch bronze statue to lend a fun aspect to the event. “A speed mixer started out with wine,” says Handal, “which is always a good idea.”

As is water. Introducing speed networking again and again over a din of angry networkers is hard on the throat. By the end of the night I was exhausted, but didn’t help that I’d made the mistake of sitting on the inside circle of the round table where I had to rotate to the next person every four minutes, leaving me just enough time to swap business cards, a notepad, and a pen while the 15 people I faced stayed seated.

As I rounded the room, I asked the attorneys, tech-services entrepreneurs, and financial planners that I met if they were repeat attendees, hence the choice of outside-circle seats—because they had gotten clients from past events. Most said they hadn’t but seemed to have made a lot of referrals. On my way out the door, Scott the hypnotist asked me to discuss that stress-reduction technique, I carefully avoided Marvin, and I offered up a little prayer of thanks for it being easier to come by a story than a client.



## WEB SOLUTIONS 2006

Progressive Ideas and Leading Technologies



and full reports and related information go to the links listed below or visit [www.technology-reports.com](http://www.technology-reports.com)

## Eliminate Payroll Headaches: Demand Software for Small Business

Online services are revolutionizing how employers handle payroll, transforming a task that used to take hours of manual work into a minor task involving just a few clicks. In order to guaranteeing accuracy, these online services incorporate user-friendly tools that help employers manage the entire payroll process from printing paychecks to filing W-2s. For an employer has one employee or more, payroll is an operational necessity, but not always easy. Employers must accurately calculate withholding amounts and voluntary deductions, make timely tax deposits to

various government agencies, and file ever-changing tax forms throughout the year. Payroll withholding amounts can change during the year, so small businesses often calculate taxes incorrectly, leading to penalties.

Surprisingly, although managing payroll manually is error-prone and time consuming, 66% of small businesses still handle all or some of their payroll on their own, according to a recent NFO study. The traditional alternative, an outsourced payroll service, carries a high monthly cost and automatic tax impounding every pay day. Employers that go this route give up control

of their cash flow and end up paying taxes before they are due.

Online payroll is completely changing the game. Employers simply log into their payroll account, enter hours worked for each employee, and click to receive instant paycheck calculations. All federal and many state tax payments can be submitted electronically and pre-filled federal and state tax forms can be filed electronically or printed and mailed to the government agency.

Small business owners want a payroll solution that is easy, accurate, convenient and cost-effective. New online payroll services use the Internet to automate tedious payroll tasks, making it quicker, easier and less expensive for small businesses to maintain control of their payroll.

To read the full report, go to  
[www.technology-reports.com/paycycle.asp](http://www.technology-reports.com/paycycle.asp)

**PayCycle** is the leader in on-demand payroll, targeting small businesses and the accountants who serve them. Servicing more than 30,000 small business employers, PayCycle's mission is to make paper-based payroll obsolete. The company's award-winning "Do-It-With-You"™ technology platform guides customers through the entire payroll process from paychecks to W-2's. By integrating with leading small business accounting packages, including QuickBooks® and Microsoft® Money, PayCycle eliminates the hassle of data re-entry. [www.paycycle.com](http://www.paycycle.com) • 1-866-729-2925

## Interactive Voice Messaging: An Efficient Way to Contact Your Customers

World that is often ever changing, fast and extremely competitive and time sensitive. Can you effectively communicate with your customer base? Today, there are many communication methods available including: e-mail, text message, traditional mail, traditional technology and interactive voice messaging, just to name a few. Whether you are developing a communication plan for a strategic marketing campaign, for customer retention and education, or if you are working on a particular plan for your school or community, your plan should carefully consider the tar-

get audience and the most effective way of communicating with this audience.

With the recent advancements in web and voice-over-internet-protocol (VoIP) technology, using interactive voice messaging as an effective form of communication has never been more efficient and cost effective, compared to many of the other alternatives. When considering the use of interactive voice messaging as a communication tool, consider the security of the system, ease of use, speed of delivery, capacity, technical support, training, and cost.

When comparing interactive voice messaging systems, primary consideration should be given to the following system features:

- A provider that requires no purchase of hardware, software, or telecommunication lines
- Ability to upload call list from a variety of formats
- Flexible messaging strategies
- Convenience and ease of use
- Real-Time Process for Creating Call Campaigns
- Real-Time extensive reporting viewable via the web

Communication is the key for sustained growth and customer retention. Voice messaging offers a very unique communication tool which must play a vital role in your future marketing campaigns.

To read the full report, go to  
[www.technology-reports.com/globalconnect.asp](http://www.technology-reports.com/globalconnect.asp)

**Global Connect LLC**, is the leading provider of web based voice broadcasting used to deliver personalized voice messages by various industries throughout the United States, Canada and Puerto Rico. Global Connect's fully interactive system uses Voice Over Internet Protocol to deliver prerecorded voice messages to designated phone numbers at unmatched speed and capacity. For more information, call 1-888-421-4151 or visit [www.gcl.com](http://www.gcl.com).



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## Mining Golden Nuggets from Your Knowledge Base and Product Line

We're all content companies now. From traditional publishers to trade associations, financial institutions to multinational telcos, almost every successful organization sits atop a trove of accumulated customer and market intelligence, audio and visual media, sales research or sheer technical expertise. Media companies have vaults of music and video assets they may never have considered selling before. But all companies of all stripes live and breathe on executive speeches, marketing presentations, training videos, even podcasts, licensed music libraries and short films. Much of this undiscovered gold remains locked away or scattered in

so many pieces few of us consider its potential value to others. Increasingly, companies and publishers of all sorts are finding ways to re-package their content for sale to new markets and audiences. Without the cost or bother of paper and mailing, the decision to publish reports, articles or even databases is easier now than ever before.

Or is it? Bringing your content online for purchase by consumers or other businesses certainly can help your bottom line. It can also carry your brand to new audiences. Publishers can leverage forgotten media libraries made "classic" by time. Trade associations might find information of

tremendous value to consumers. A genealogist may be sitting on a silo of family company data that, if packaged properly, is priceless to just the right business niche.

But like any business move, the decision to sell content really involves a series of more considerations. What content does your company really hold, and where? How much of it do you truly own, or do others hold so-called photo and copy rights? Just about anyone can open an online storefront but how much burden does your company want to keep or out-source to others?

The decision tree for selling your content online can be rewarding and profitable to the extent it takes sure footing and a clear path to success.

To read the full report, go to  
[www.technology-reports.com/javien](http://www.technology-reports.com/javien)



Javien's comprehensive order management and fulfillment technology provides a flexible ASP solution so you can offer a variety of incentives and payment options. Through a web interface you get a complete merchandising solution—administer your digital products, manage your customer information and communications, run sales reports and get secure storage of customer data. Additionally, Javien's adaptive micropayment aggregation engine can reduce the cost of processing small payments. 866-383-4586 • [www.javien.com/](http://www.javien.com/)

## That's One Big Store! and Over 200 Million People are Waiting in Line

Since the 1990's, the Internet has doubled in size every six months. With the Internet as the storefront for e-commerce, and a storefront that is open 24x7 and available from anywhere in the world with internet access, this constant increase offers far more than hope for those wishing to sell online. With customers and information seekers already waiting in line (as of March '06 there were 205,326,680 internet users in the United States alone), online selling is a thing of the past and even more so of the future.

### In 2005:

- Online retail sales came in at about \$165 billion, a 20% increase over 2004. Growing 23% from the same season in 2004, holiday sales were at \$22 billion.

### In 2006:

- From January through June, online spending by consumers totaled \$80.8 billion, up from \$67.2 billion during the same period of time in 2005.

Time-travel that is well worth it.

As the internet grows, so grows competition. Waiting too long to move online may cause you to lose your place in line. If you are already online pat yourself on the back but now that you're there—don't stop. An online business must keep on its toes, moving ahead, such as having top features and quality on a well-designed, easy to navigate website.

### In 2010:

- Online retail sales are projected at \$329 billion.

Moving forward is the only direct path to become part of that rising number.

\*\* All stats gathered from leading industries in internet

To read the full report, go to  
[www.technology-reports.com/volusion](http://www.technology-reports.com/volusion)



Since 1999, Volusion.com has offered E-commerce Solutions, Web Design, Merchant Accounts, SSL & Search Marketing to clients. All solutions come standard with built-in business and marketing functions in a customizable package, including Page Checkout, Google Checkout integration plus Free 24x7 Support & training videos. Try a Free 14-Day Trial Today! New store setup with the code BWEEK expires 10/31/06. [www.Volusion.com](http://www.Volusion.com) • (800) 646-3517 • Simi Valley, CA & Australia

## WEB SOLUTIONS 2006

Progressive Ideas and Leading Technologies

# Maximizing Your Email ROI: Why Your Reputation Is More Important than Ever

Nice guys always finish last. Take a glance at the current state of email, and you might think it was headed in that direction. Thanks to the unrelenting tenacity of spammers who pollute our inboxes with penny stocks and Viagra offers, one of a company's greatest challenges is just making sure their emails don't get lost in the sea of spam. In fact, when you've gotten the email medium to a science in terms of compelling and targeted messaging, the greatest barrier to the success of email programs may be getting the inbox.

Well over 80 percent of email sent over the Internet is spam. The unfortunate result is that while message security vendors and ISPs are working overtime trying to keep unsolicited messages away from their end users, they're also frequently misclassifying legitimate mail as spam. As system administrators tighten their requirements for what constitutes "good" mail, many legitimate emails are getting accidentally routed to bulk folders, or dropped altogether. Called a "false positive", this can just as easily happen to an email receipt for a stock trade as to a special offer on this season's latest gadget.

With more legitimate businesses mistaken as spammers and vice versa, your online reputation has become more important than ever. While Internet blacklists already exist to help identify and block known spammers, having a good email reputation can get your emails delivered directly to the inbox.

The first step towards building a good email reputation for your corporation is to ensure you follow the latest industry best practices. By maintaining high standards in your email practices, you can increase delivery rates to the inbox, which mean higher response rates, which mean greater ROI. Sometimes, nice guys do finish first.

To read the full report, go to  
[www.technology-reports.com/habeas.asp](http://www.technology-reports.com/habeas.asp)

**HABEAS** Habeas is an Email Trust Authority that re-establishes email as a reliable business communications medium. Habeas enables commercial email senders to certify their communications as legitimate, and helps ISPs and message security vendors make better, more efficient decisions about how to sort inbound mail. By aggregating, analyzing, and categorizing the reputations of millions of senders around the globe, Habeas is making sure legitimate email gets delivered. Mountain View, CA • 650-694-3300 • [www.habeas.com](http://www.habeas.com)

# CRM Software Solutions: Improving Customer Satisfaction

Enterprise feedback management (EFM) systems have gained an increasingly prominent place in the suite of tools used in customer relationship management. Their usefulness is not limited to surveying customers about satisfaction with your product or service. In fact, all the customer data in the world isn't of much use if you can't close the loop and use the information gained to provide continuous improvement to your customers' experience. EFM works with your existing customer systems to help you understand what your cus-

tomers want and why they want it. With this added dimension of insight, you will be better

**"...you will be better able to design process improvements and quality standards to enhance your customers' satisfaction."**

able to design process improvements and quality standards to enhance your customers' satisfaction.

Once you rolled out your process improvements and quality standards, EFM helps you

measure the performance of your organization in implementing them, as well as their impact with your customers. Using sophisticated mobile data gathering, EFM lets you gather data where it lives: on the factory floor where your products are assembled, or on the retail floor where they're sold.

By using EFM -- both outside your organization to monitor customer desires, and inside your business to monitor processes and quality control -- you can close the loop on customer satisfaction, enabling you to deliver your customers service and product improvements more quickly and with a higher standard of quality.

To read the full report, go to  
[www.technology-reports.com/prezza.asp](http://www.technology-reports.com/prezza.asp)

**prezza TECHNOLOGIES** Prezza Technologies builds innovative web-based and mobile survey tools with an emphasis on quality, performance, and usability. Prezza Technologies' customers are able to easily deploy even the most complex surveys & data collection applications in a fraction of the time required by the competing products. Prezza Technologies' applications are designed to be used and maintained by non-IT professionals, thus reducing the load on an organization's IT resources. [www.prezzatech.com](http://www.prezzatech.com)





**RICH** Foie gras with candied olives, green peas, and clarified beet juice



**SUMPTUOUS** Tender spiced lamb is marinated with carrot honeydevils and fava bean puree

# Feed Your Mind

Chefs like Wylie Dufresne of New York's wd~50 are experimenting with "molecular gastronomy," challenging diners' palates—and heads. **BY ADRIENNE CARTER**



**IT LOOKS LIKE** a perfect fried egg, sunny-side up. The yolk even oozes properly when pierced with a fork. Then I take a bite and my taste buds are delightfully shocked. The yolk is sweet with hints of carrot juice and maple syrup while the white speaks of coconut and cardamom. **What is this stuff?** Culinary *trompe l'oeil*,

that's what. The egg is the second course on the 11-dish tasting menu at wd~50, chef Wylie Dufresne's restaurant on Manhattan's Lower East Side. Here, as I quickly realize, things are not as they appear. Dufresne, a bespectacled young chef with shoulder-length brown

hair, wants you to expect the unexpected, whether flavors, textures, or presentation. You won't find pedestrian pasta or cliché chicken preparations at Dufresne's restaurant, or at chef Grant Achatz's Alinea in Chicago, Heston Blumenthal's The

Fat Duck in Bray, England, and Ferran Adrià's elBulli in Cala Montjoi, Spain. Instead, these leaders of an avant-garde culinary movement known largely as "molecular gastronomy" blend cutting-edge scientific techniques and equip-

ment—such as enzymes, lasers, and liquid nitrogen—with more traditional practices. The end product is unique, to say the least, and appeals to diners with an adventurous spirit.

Followers of molecular gastronomy look to understand the scientific processes behind cooking—for example, figuring out what temperature a yolk cooks at compared with the white, or how a one degree difference in temperature can affect the roasting of beef. The movement has attracted not only avant-garde vanguarders but mainstream chefs with an intellectual curiosity. Nick Spinelli, executive chef at the nation's No. 1 foodmaker, Kraft Foods, and Even Nathan Myhrvold, the former technology officer at Microsoft, are experimenting with the concept in his





**PLAYFUL** Beef tongue with fried mayo and tomato molasses hints at the flavors of a bologna sandwich



**SAVE ROOM** Dark chocolate ganache with avocado puree, licorice syrup, and lime ice cream

en, which is decked out with high-gear. "We're learning. We're becoming better cooks," says Dufresne. "It's a misconception that we're the crazy chefs who wear coats."

It's easy to see why there might be confusion. The \$105-a-person tasting menu at wd~50 is like taking a tour through the left and right sides of Dufresne's brain. With intellectual savvy and an unorthodox approach, he serves up surprising flavor combinations like fried eel and whipped caramel and pretzel breads in an entirely different form. In the shrimp cannelloni, for example, the filling is made of shrimp. To prepare it, he

uses the shrimp and coats it with an enzyme, bromelain, that breaks down the protein to make it so tender he can create a pasta-like wrapper. In your mouth, it has the feel of pasta, but the texture of shrimp. The chef combines the shrimp, dates, Thai chili, and preserved lemons so the dish delivers the shrimp flavor in different ways. To mimic the egg-like texture of his carrot-coconut "sunny-side up," Dufresne uses industrial gums, like locust bean gum, usually found in processed

meats, its bits of scallions and shitake mushrooms. But instead of the usual chunks of clarified tofu, diners get a small plastic bottle of a pasty sesame tofu. Dufresne mixes in methylcellulose—a chemical compound derived from cellulose—so that the paste gels into a "noodle" when it hits the hot soup. At wd~50, it's O.K. for grown-ups to play with their food.

The dish of beef tongue, fried mayo, and tomato molasses has the flavors of a bologna sandwich. But Dufresne manipulates the textures so that it's a completely different experience from the lunchbox standard. The thinly sliced braised beef tongue is accompanied by fried cubes of mayonnaise, warm and creamy on the inside and crusty on the outside. The rich, smoky paste of tomato and molasses is akin to a fine barbecue sauce.

The innovations don't end with the main course. Desserts, now under the watchful eyes of Alex Stupak, formerly of Alinea, often include the sweet and the savory. A peach puree is paired with a buckwheat-flavored ice cream. In another, a

dark chocolate ganache is accompanied by an avocado puree, a licorice syrup, and a lime ice cream.

Interesting. But is it any good? Looking around the dining room, you'll see patrons peering at the end of their forks contemplatively before they take a bite. During my meal, my dining companion and I chatted with the strangers at the table next to us about the distinctive flavor pairings, the unusual textures, and our impressions. We were delighted by the tender spring lamb with carob, honeydew, and fava beans. Not every dish was a hit. The foie gras with clarified beet juice, while amazing at first, was too large a portion for such a rich dish. What really stands out, though, is the journey. Here, dinner is an intellectual and sensory experience that provokes discussion.

It's part of the fun of wd~50. It's also a big reason such restaurants remain a niche category. These meals don't evoke the same emotional cues as more traditional ones, and some won't find this type of cooking satisfying. "When you take food in this direction, it becomes less rooted in tradition and more an expression of that chef's vision," says Harold McGee, author of *On Food and Cooking*, one of the bibles of the molecular gastronomy movement. Dufresne's egg may not be conventional, but it's definitely worth a taste. ■

**BusinessWeek** online For a look at signature dishes of other avant-garde chefs, go to [www.businessweek.com/extras](http://www.businessweek.com/extras)

## Playing with Food

Where the culinary avant-garde works its mouth-watering magic

**ALINEA** Chicago  
312 867-0110

**ELBULLI** Cala Montjoi, Spain  
34 972 150 457

**MINIBAR AT CAFE ATLANTICO**  
Washington  
202 393-0812

**MOTO** Chicago  
312 491-0058

**THE FAT DUCK** Bray, England  
441628 580 333

**WD-50** New York  
212 477-2900



# Which Way to the Autobahn?

Slide into the driver's seat of the BMW M6, glance at the speedometer topping out at 200 mph, and you'll be looking for some open road. **BY DAVID KILEY**

## The Look

Its design is perhaps the least daring of BMW's recent models. The M6 cuts as sensible a figure as a banker's blue suit from Savile Row. Like the best of Bimmers, it's more athletic than muscled.

**Heads Up** There's a convenient and welcome display on the windshield that shows speed, gear selected, and a tach dial.

**Up on the Roof** The top looks like NASA-created fabric. It's carbon-fiber that reduces the weight, thus lowering the car's center of gravity. A convertible M6 goes on sale in the U.S. next year.

**Tight Squeeze** I don't know any adults who would ever be riding in back of this so-called 2+2. My Corolla weekend bag, or my pre-schooler or one of his mates, just fit.

**Fore!** The trunk swallows up two big golf bags.

**Me, Tired?** The Pirelli P Zero Cori tires are made for speed but can provide a harsh ride on anything smooth asphalt.

**Gimme a Brake** And they did. Four beauties. The brawny 13.7-inch-dia front and 13.6-inch rear discs are ventilated, cross-drilled, and fabu at bringing those horses to a stop.

**Competitors** Jaguar XK, Porsche Mercedes-Benz CLK55 AMG, Aston Martin V8 Vantage.

**Base price \$96,100**



## The Engine

The 5.0 liter V-10 reaches 500 hp when you engage the "power" mode. It goes from zero-to-60 mph in 4.4 seconds. The engine hits the 7800 rpm yellow line on the tachometer with a purr instead of a groan. Slurp: only 14.5 mpg.



## The Interior

Old World leather and wood meets 21st century digital driving

**Creature Comforts** Finely stitched leather seats are adjustable for width to cope with side-to-side movement on back roads or to accommodate a spreading middle-age butt. First class, ear-wax-loosening stereo.



**To Shift, or Flip** Use the cool paddle shifters (1), or the floor shifter (2). Choose different transmission and suspension settings to maximize comfort on highway trips or canyon twisties.

**There's a Mouse in M** The iDrive is a console mounted mouse-like (3) that controls the entertainment, navigation and communications systems on an LCD screen (4). I found it easy to

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# Leave Home Without It

Checking luggage is a big hassle at airports. Enter baggage delivery services. **BY LARRY ARMSTRONG**



**W**HEN ROBERT and Janet Nisi and their four children were packing for their August vacation to Colorado Springs, they didn't worry about the endless lines to check in luggage at the airport. Instead, they called Luggage Free, which came to their River-

side (Conn.) home, picked up and wrapped their six bags in plastic, and delivered them directly to the Broadmoor Hotel & Resort.

The one-way cost? A couple of hundred dollars: a dollar a pound for the luggage, plus a flat fee of \$75 for a set of golf clubs and a \$40 pickup charge. "For us, it makes traveling a real pleasure instead of a chore," says Janet, a stay-at-home mom whose husband is a partner

at a New York hedge fund com. Their bags will get home the same. "They'll pick them up from concierge after we leave." The Nisis only carry-ons? Wallets, a player, and a magazine.

Now, in the wake of the Transportation Security Administration's Aug. 10 down on liquids and gels in carry-on bags, the lines to avoid at airports are ones for checking bags, whether

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Start

Update the  
Excel spreadsheet,  
or just finish  
reading this article?

## No Schlepping, No Waiting

What it costs to ship a small, 35-lb. suitcase, insured for \$1,000, from Los Angeles to New York

| COMPANY/<br>WEB SITE/PHONE                                             | OVERNIGHT       |
|------------------------------------------------------------------------|-----------------|
| <b>Luggage Concierge</b><br>luggageconcierge.com<br>800 288-9818       | <b>\$182.53</b> |
| <b>Luggage Forward</b><br>luggageforward.com<br>866 416-7447           | <b>206.00</b>   |
| <b>Luggage Free</b><br>luggagefree.com<br>800 361-6871                 | <b>460.00</b>   |
| <b>SkyCap International</b><br>skycapinternational.com<br>877 775-9227 | <b>131.27</b>   |
| <b>Sports Express</b><br>sportsexpress.com<br>800 357-4174             | <b>184.20</b>   |
| <b>The Luggage Club</b><br>theluggageclub.com<br>877 231-5131          | <b>188.50</b>   |
| <b>Virtual Bellhop</b><br>virtualbellhop.com<br>877 235-5467           | <b>141.00</b>   |

Data: Company reports



Orlando: Travelers with a reservation at a Disney hotel get luggage tags that let them breeze through the Orlando International Airport. Your bags are

delivered from your home airport to your hotel room, and you can get boarding passes and check your bags for the return flight in the hotel lobby, all for free.

The company that handles the Disney-bound luggage, BAGS (for Baggage Airline Guest Services), offers a similar but out-bound-only service for \$10 a passenger from convention centers in Orlando, New York, Chicago, and San Francisco and a few hotels in 16 cities.

The company has landed national contracts, including one with Hyatt Hotels & Resorts, which plans to have the service in its lobbies in cities where BAGS operates by the end of the year. Currently, it's offered only at a Hyatt Regency in Dallas, but five hotels in Denver and San Diego will be added in September. Also in Sep-

tember, BAGS will start checking luggage at the Park 'N Fly Plus lot at the Atlanta International Airport, and that airport parking lot operator plans to roll out the service nationally. For now, at least, Park 'N Fly is picking up the tab. (At airport-owned parking lots in San Francisco and, soon, Chicago and Los Angeles, BAGS charges \$5.)

Another company, Bags To Go, runs remote bag-check services for Southwest Airlines passengers from the Las Vegas Convention Center. BaggageDirect is trying to sew up the Hawaii market, with luggage pickup and delivery to homes, offices, and hotels in Oahu and Maui, as well as Los Angeles, San Francisco, and San Diego. If you're traveling to or from the rest of the country, you can bypass the waits at airports in Hawaii, but you still have to check and retrieve your bags at your home airport. BaggageDirect's fees start at \$30 per passenger each way, with discounts for families. ■

**More checked bags mean vastly longer lines**

side skycaps or at terminal check-in counters. The airlines report that as many as 90% of all passengers now pre-bag to check. As a result, baggage transfer services, once pretty much limited to shipping such sports equipment as golf clubs, and bicycles, are booming. "We saw our business almost double overnight," says Jeff Boyd, president of New York-based Luggage Free.

If you want to fly from Point A to Point B without hassling with your luggage, you have a couple of choices. You can hire one of a half-dozen or so luggage forwarding services, such as Luggage Free (table). Or you can pick up your bags at your home office and deliver them to your destination hotel or vacation home, and vice versa. They arrange for pickup and delivery, operate internationally, and often use such carriers as FedEx or United Express Service. You'll pay top dollar, especially if you need your bags overnight. In the meantime, you can save almost 50% off the cost of Luggage Free's service; her bags arrived at the hotel in two.)

## THE LINES

IN SOME MARKETS, newer remote luggage services are a second option. Geographical coverage is spotty, though, and remote home pickup and delivery is rare. In many, these companies mostly operate out of hotels and convention centers. They check your bags and issue boarding passes in the hotel lobby, for instance, and then they truck your luggage to the airport to escort it through the screening process, and load it on your plane. Generally, you meet up with your bags at the airport on the other end.

One variation thereof. The biggest variation is Disney's Magical Express in

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# Train with Gizmos The Pros Use

Bikers get a performance boost with devices that track their pace and heart rate. **BY JAY GREENE**

**A**S A CYCLIST, I HAVE met my match. I've been training for a 150-mile, two-day ride in early September north of my Seattle home. As hard as I push myself to go up hills, there's always another cyclist just a bit ahead of me. It's hard to get too frustrated, though, because I've created the monster—a virtual rider that I pro-

grammed to appear on the screen of Garmin's Edge 305 (\$433), a cyclometer that I've been testing.

Slick software allows me to set the amount of time it will take for the rider to cover a specific distance. Then I race against him. The Edge shows how far ahead or behind I am, and it even has two icons zooming along, illustrating who's in the lead. My rider always seemed to inch ahead of me up the hills. Garmin calls

him a Virtual Partner. I've dubbed the Butt-Kicker.

Today's technology allows recreational riders like me to train like the pros. The Edge 305, which also allows you to track 32 data points, including speed, distance, pedaling cadence, and heart rate, is my favorite of four gadgets I recently tested. But all four motivated me to work harder and pedal more efficiently.

Each device comes with software applications that give you the tools to improve performance by downloading data to a PC. I could chart my times to see how my speed improved over the same course. I could measure the watts of power I produced while pedaling. Even little bits of data, such as pedaling cadence or power-to-weight ratio, provided mental motivation and gave me clues on how to improve my training regimen.

Like all the gadgets I tested, the Edge 305 comes with a strap that goes around the chest and sends heart rate information wirelessly to the receiver. Its monochrome screen, nearly 2 inches diagonally, mounts on handlebars and allows you to customize up to eight different functions for on-display viewing.

The Edge 305 benefits from Garmin's expertise in making global positioning system satellite devices. With GPS data, it can navigate routes and track performance over the same course so you can see improvement. It can even tell you the approximate time of sunrise or sunset based on your location.

If you want more from your training, CycleOps offers the \$1,200 PowerTap. In addition to tracking speed, distance, heart rate, and the like, the PowerTap measures the amount of power, in watts, that you generate as you pedal. The device is embedded in the spokes of the back wheel, and comes with a



## Well-Informed Pedaling

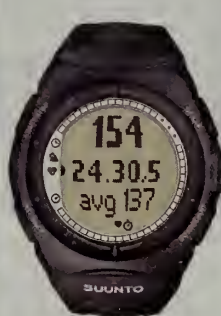
These digital gadgets can help you become a better rider



**POLAR S725X**  
has a customizable display



**CYCLEOPS  
POWERTAP SL**  
gauges power



**SUUNTO T6**  
has too many display screens to check



**GARMIN EDGE 305**  
provides GPS readings

is mounted on the handlebars. Power measurement is a fairly new increasingly used by elite riders. because it's the purest performance: a calculation of the amount of energy expended in a given time. The behind the PowerTap is to get riders feel their current maximum power output, then train to generate even more. For what it's worth, 2006 Tour de France champion Floyd Landis used a PowerTap during his training and his disputed victory.

The PowerTap is really beyond my leveling. I averaged around 150 watts of power. Compare that with the 280 watts that Landis averaged during his controversial Stage 17 ride in the Tour, including an astounding 544 watts in the first 10 seconds of his initial acceleration out of the pack. To be fair, I got only a few weeks of training with PowerTap. I see that, after several more weeks of increased use, I would start to crank up the power. But it requires hard-core training to move the needle.

For those who run as well as ride, a heart-rate monitors connected to computers can help push performance. They can be worn on your wrist for running or mounted on a bike's handlebars for a ride.

Polar's \$350 S725X is a great heart-rate monitor, and with the quick installation of a sensor to the front fork of a bike and a magnet to a spoke on the rear wheel the watch can gather speed and distance information as well. Suunto's \$70 T6 watch, with its \$70 Bike Pod sensor, has a nifty altimeter to track elevation that's much easier to use than the Suunto version. The drawback to the T6: You have to navigate among various screens to find the elevation, time of day, or heart rate. It would be nice to cus-

tomize a screen to include the specific data fields that a rider wants, something the Polar does well.

With both watches, runners can shell out a few more dollars for foot pods that attach to sneakers and measure the distance covered. My biggest gripe about the watches was their small displays. They just didn't have enough digital real estate to provide all the information I wanted on one screen. Instead, I had to fumble

with various buttons as I was riding.

No one's going to confuse me with a world-class cyclist. But these gadgets will help me finish my 150-mile ride more efficiently. As for the Butt-Kicker, I could just reprogram him to slow down. But it's more fun trying to catch him. ■

**BusinessWeek** online For a slide show on bike training gear, go to [www.businessweek.com/extras](http://www.businessweek.com/extras)

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BY ROBERT PARKER

# Don't Tell Them It's from Washington

**MY COLLEAGUE**, Pierre-Antoine Rovani, covers the wines of Washington State in detail. The Columbia Valley, on the drier, sunnier side of the Cascades, has been described as having great but largely unfulfilled potential. Still, many fine wines are produced there, and here are Pierre-Antoine's ratings and tasting notes on a few of the worthy ones—including a 100-point cabernet sauvignon.

**L'Ecole No. 41 2004 Semillon Fries Vineyard Wahluke Slope**

**90 points.** This wine bursts from the glass with scents of ripe pears, smoke, and tangerines. With aeration (those who decant this beauty will be recompensed), it offers a medium-bodied core of satiny melon, pear, red currant, and tangerine zest flavors. Drink it over the next three to four years. \$20

**Chateau Ste. Michelle 2004 Chardonnay Ethos**

**92 points.** Fashioned from three vineyards, this terrific chardonnay is bursting with spices. Medium- to full-bodied, it reveals spicy pears in the attack that build in intensity through the mid-palate and then return with a vengeance in its long, sappy finish. A highly concentrated white, it is satin-textured and wonderfully balanced. Drink it between 2007 and 2015. \$30

**Januik 2003 Cabernet Sauvignon**

**94 points.** Cassis and copious quantities of red fruits are found in the

aromatic profile of this sublime cabernet sauvignon. A deep, broad, lush wine, it is an edgeless, harmonious, sultry, medium- to full-bodied delight. Loads of red cherry syrup, blackberry liqueur, cassis, and black cherry nectar flavors are found in its sensual personality.

This decadent effort lustfully satisfies corporeal pleasures. To top it all off, its long, supple finish slathers the taste buds with additional waves of luxuriant fruit. At this price, it's a no-brainer! Projected maturity: now to 2016. \$30



**Columbia Crest 2002 Walter Clore Private Reserve Red**

**91 points.** Named for a pioneer of the state's wine industry, it has demure aromas of blackberries, sage, vanilla, and rosemary. A blend of 63% cabernet sauvignon and 37% merlot, it wows with its concentration and depth of fruit. Medium- to full-bodied, the wine coats the palate with a myriad of spices, dark berries, and tar. Its extensive, seamless finish reveals additional fruit as well as a slight hint of menthol. Drink it between 2008 and 2016. \$35

**Spring Valley Vineyard 2003 Frederick**

**94 points.** Bursting from the glass with ca dark fruits, the blend of 75% cabernet sauvignon, 19% merlot, 5% cabernet franc, 1% petit verdot is a hugely thick, dense merlot. Its immensely powerful core of fruit is cranked with licorice, tar, and blackberry liqueur. This mouth-staining, palate-conquering wine is as ripe as it is muscular, revealing loads of smooth round tannin in its extensive finish. Projected maturity: 2010 to 2023. \$40

**Quilceda Creek 2003 Cabernet Sauvignon**

**100 points.** Dark-colored and powerful cabernet sauvignon displays mouth-watering aromatics of black chocolate, sage, and blackberry liqueur. The awe-inspiring cassis liqueur, violets, blueberry nectar, cherry syrup, and chocolate is immensely muscular yet elegant. Texturally reminiscent of liquid velvet, it paints the palate with oodles of fruit, displaying unreal depth, balance, and length. Wow! Projected maturity: 2010 to 2024. \$95

Visit [www.eRobertParker.com](http://www.eRobertParker.com) for the Internet's most active wine bulletin board, tens of thousands of tasting notes, or order his recent book, *The World's Greatest Wine Estates: A Modern Perspective*. You can also subscribe to Parker's newsletter, *The Wine Advocate*. Request a sample copy at: *The Wine Advocate*, P.O. Box 311, Monkton, MD

Wines rated from 96-100 are extraordinary; 90-95, excellent; 80-89, above average to very good. For more Parker picks, go to [businessweek.com](http://businessweek.com)

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# Taking Stock of Your Adviser

Many investors don't know how to evaluate the person in charge of their portfolios. These seven questions should help. **BY LAUREN YOUNG**

**THEY COME BEARING DIFFERENT LABELS:** financial advisers, financial consultants, financial planners, and registered representatives. A few still go by the moniker of broker. Whatever the name, an estimated 650,000 of them provide services to individual investors. How do you know if the adviser you're working with is any good? There's no central database that lets you punch in an adviser's name and pull up basic data on performance, risk, fees, or background. "The most surprising thing is that so little research is done on [advisers]," says Peter Tufano, professor of financial management at Harvard Business

School. No wonder that 92% of investors surveyed say they don't know how to assess the quality of their advisers, according to an online poll of 1,052 investors by Paladin Registry, a service that helps investors select financial professionals.

In interviews with dozens of investors and financial advisers, *BusinessWeek* found that evaluating your adviser requires some rigorous quantitative analysis as well as subjective scrutiny. Here are the key questions to ask:

## How well am I doing?

Many people make the mistake of comparing the performance of their investments to a popular stock market measure, such as the Dow Jones industrial average or the Standard & Poor's 500-stock index. Stephen Wetzel, a certified financial planner in Yardley, Pa., says your adviser should be giving you reports comparing your results with a composite of indexes

that mimics your asset allocation strategy. So if your plan is to have 75% in stocks and 25% in bonds, your benchmark could be 75% S&P-500 and 25% Lehman Brothers U.S. Aggregate Bond index.

## How much is it costing me?

The job of a financial adviser is to make money for you, so if your portfolio is growing, that's a good sign. But at what price? At a bare minimum, advisers should provide gross returns as well as net returns so you can assess how much you're paying for performance, says Jack Waymire, author of *Who's Watching Your Money* and founder of the Paladin Registry ([paladinregistry.com](http://paladinregistry.com)). If the difference between gross and net returns is more

than 1.7 percentage points, ask your adviser for a discount on the fees. Give your adviser the boot if you are paying more than two percentage points of expenses on a million portfolio, he says.

**Am I getting good recommendations?** When your adviser suggests a mutual fund, ask how long she has been in the fund. "If this is a fund the adviser started recommending, you want to know why," says Randy Kurtz, chief investment officer of RK Investment Advisors, a New York money management firm. Advisers should always be able to suggest several alternatives, too.

Truth be told, advisers don't have a great track record picking funds, according to a study co-authored by Harvard's Tufano. Looking at data from 1990 through 2004, the study found that funds brokers select—especially equity funds—deliver lower risk-adjusted

turns than funds picked by individual investors. Results are even worse when sales charges are factored in. The study also found that do-it-yourself investors did a better job of timing the market than advisers.

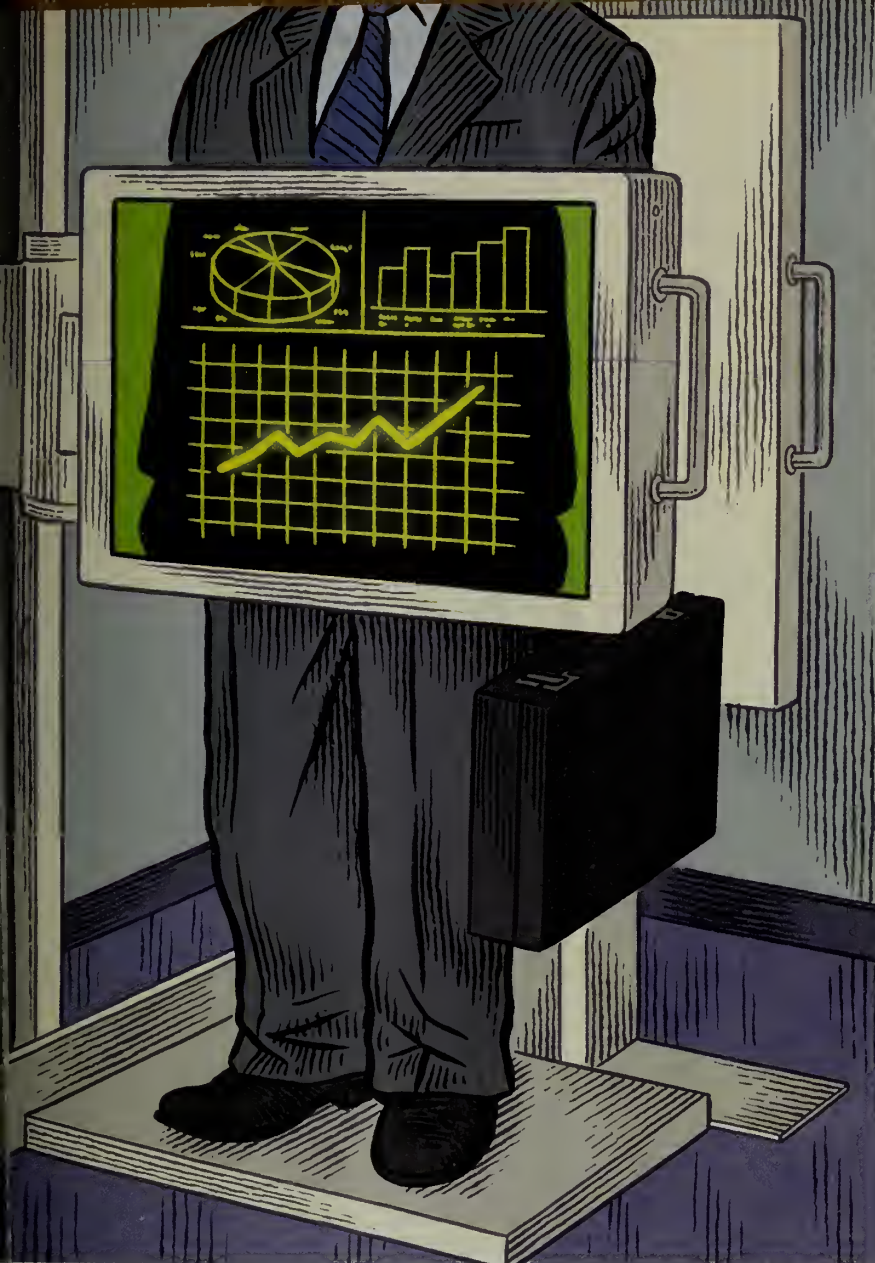
Your adviser also should be up-to-date on the investment vehicle. Do they hedge funds? Do they trade change-traded funds? Do they trade private equity. So po

## THE STAT

**92%**

of 1,052 investors polled say they don't know how to assess advisers

Data: Paladin Registry



ns about those to see what kind of  
e you get.

#### Adviser putting my interests first?

er when Coco Lewis, a real estate  
Fremont, Calif., wanted to cash  
one of her portfolio to invest in  
er, she asked Jennifer Cray, her fi-  
adviser, to review the investment.  
oy did Cray agree that Lewis  
withdraw \$125,000 from her  
op, she rebalanced the portfolio  
n 4 hours. "I feel like she really  
out what's happening with my  
ey says Lewis, 54.

#### How often do I hear from my adviser?

ng together on a regular basis is cru-  
o discuss results and make neces-  
sary changes. "People think they can re-  
view their portfolio once a year, but  
well 2000 was up double digits in  
first quarter," says Thomas Meyer,

chief executive officer of  
Meyer Capital Group, an  
advisory firm in Marlton,  
N.J. "You can't wait a year  
to tweak your portfolio."

Dr. Charles Gaudet,  
a plastic surgeon in  
Portsmouth, N.H., values  
Jennifer Lane, his Boston-  
based adviser, because she's  
constantly in touch—once  
a week by e-mail, every  
other week on the phone,  
and he meets with her fre-  
quently. Not every investor  
needs or wants that kind of handhold-  
ing, but you should be getting updated  
at least quarterly.

#### Do I need more than investment management?

Making investment decisions may be all  
you need from a financial adviser, but

most people require a broader  
range of services, such as debt and  
expense management, tax advice,  
and college planning. Is your adviser  
capable of providing that?

In addition to overhauling his  
wills, insurance, and college sav-  
ings accounts, Gaudet's adviser  
may have even helped with his  
marriage. At Lane's urging,  
Gaudet and his wife, Cappy Whe-  
lan, now sit down once a week to  
pay bills, rather than waiting to  
do it once a month. "We haven't  
always communicated well in  
terms of money," Gaudet, 56, ad-  
mits. When he wanted to save for  
retirement, his wife preferred to  
spend on a vacation. Now, he's  
confident that he'll be able to re-  
tire at 65.

#### Still not sure if your adviser is up to snuff?

Ask for advice from someone you  
trust, such as an accountant or  
lawyer. Carole Edelstein, 60, a wid-  
ow in Fort Lauderdale, recently got  
a vote of confidence for her adviser  
after her estate attorney, Mo El  
Deiry, reviewed her portfolio. The  
combination of separately man-  
aged accounts as well as her portfo-  
lio's focus on income caught El  
Deiry's eye. In fact, El Deiry liked  
what he saw so much that he asked  
Edelstein's adviser, Harold Pomer-  
anz of Ryan, Beck in Hewlett, N.Y.,  
to come to Florida to meet a dozen  
other clients, many of them widows  
on a fixed income.

### Do your fees on a \$1 million portfolio exceed two percentage points? Get a new adviser

Or you can hire sev-  
eral advisers and let  
them duke it out.  
That's what Bob Jack-  
son, 62, a retired Hous-  
ton computer execu-  
tive, did. He parceled  
out his \$6 million port-  
folio among three dif-  
ferent advisers. After  
six months, he put one  
who wasn't performing  
well on probation, and  
fired him two years lat-  
er. Right now, the bet-

ter performing of the remaining two  
controls 70% of Jackson's holdings.

Returns are important, but Jackson  
suggests keeping tabs on your advisers in  
other ways, too, such as asking them the  
same questions. Says Jackson: "You learn  
a lot when you get different answers." ■

—With Greg Hafkin



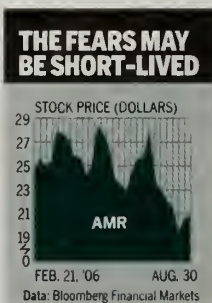


BY GENE G. MARCIAL

**FOR AMERICAN AIRLINES, THE ONLY WAY IS UP, SOME ARGUE.**  
**SUITORS COULD COME CALLING AT UNDERVALUED SCHOLASTIC.**  
**ZENITH'S INSURANCE EARNINGS KEEP UP THE STEADY GROWTH**

## AMR: Above the Storms

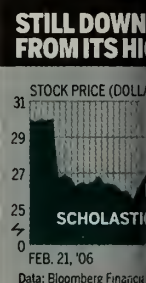
**T**ERRORIST THREATS AND LOFTY oil prices have shaken airline passengers and investors alike. Little wonder, then, that airline stocks have slumped 20% to 30% so far this year. But some fund managers say now is the time to buy. "Contrary to dire forecasts, airlines will post heady profits in 2007-08," says Vincent Carino, president of Brookhaven Capital Management. His top pick: AMR (AMR), parent of No. 1 American Airlines, whose shares tumbled from 30 in May to 20.83 on Aug. 30. AMR was featured in this column on Mar. 28, 2005, when it traded at 8.65. With revenues on the rise and costs flat to down, AMR's margins are fattening, notes Carino, whose firm owns shares. He thinks the industry's woes are fully reflected in the price. "Any drop in oil or easing in hurricane worries will drive up the stock," he argues. If oil averages \$70 a barrel, AMR, which he expects to earn \$1.90 a share this year, will make \$4.50 next year. And if it drops to \$50, he figures earnings will hit \$8. Daniel McKenzie of Credit Suisse says investors who see past the current "ugly tape and look to next year will be rewarded." Concerns are outweighed, he says, by "our outlook that AMR can report near-record earnings in 2007." He rates AMR "outperform" with a 12-month target of 35. Zacks Investment puts consensus 2007 estimates at \$3.52 a share and 2008 at \$4.57, vs. a \$4.10 loss in 2005. Fidelity owns 22 million AMR shares, or a 10% stake, after buying 1.6 million in June.



## Did Scholastic Deserve That Punishment?

**C**HILDREN'S BOOK PUBLISHER Scholastic (SCHL) is getting poor marks on the Street. Its fiscal fourth-quarter profits came in below consensus forecasts, and only two of the eight analysts who follow it now rate it a "buy." But one bull, Ivan Feinseth of Matrix Investment Research, says Scholastic, now at 30.10, has an intrinsic value in the mid-to-high 30s. Michael Metz of Oppenheimer says Scholastic is so undervalued that it "keeps showing up in our screens of buyout candidates." He thinks it's worth 40 in a sale to private equity players, who would be drawn to its assets and cash flow. In the 12 months through mid-2006,

notes Feinseth, Scholastic's free cash flow has shot up from \$7 million to \$200 million, while excess cash per share jumped from \$1.55 to \$3.75. Drew Crum of Stifel Nicolaus, who also pegs it a "buy," says 2007 will be a better year for textbook sales. Also, sales of \$195 million worth of Harry Potter books should add 60¢ to 2006 earnings, figures Crum. He calls the stock "compelling" and sees earnings of \$1.65 for the year ending May, 2007, rising to \$2.35 in fiscal 2008, vs. \$1.69 this year.



## Zenith Is 'Best-in-Class' For Workers' Comp

**Z**ENITH NATIONAL INSURANCE (ZNT) specializes in what looks like a boring business: workers' compensation insurance. But "we love boring when it delivers strong earnings growth, which Zenith has done for the past several years," says Michael Camp, a principal at Northwest Capital Asset Management, which owns shares. The stock, now 38.67, down from 55 on Jan. 31, is cheap, he adds. Matt Carletti of investment outfit Cochran Caronia Waller upped his 2006 earnings estimate from \$5.60 a share to \$6.10 based on better-than-expected results in the second quarter. Zenith earned \$3.73 last year. He says Zenith is "best-in-class," leading its peers in operating results and customer retention. By law, companies must insure employees against disability or death. Zenith's workers' comp premiums, mainly from California and Florida, accounted for 94% of 2005 revenues; the other 6% came from reinsurance, a business it had exited by yearend. Carletti sees Zenith's value rising 50%, to \$31.75, by the end of 2008, thanks to strong earnings growth and less need to build reserves against losses. Carletti's 12-month stock price target is 40.



**BusinessWeek online** Gene Marcial's Inside Wall Street is posted at [businessweek.com/investor](http://businessweek.com/investor) at 5 p.m. EST on the magazine's publication day, usually Thursdays.

**Note:** Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no direct banking or other financial relationships with them.



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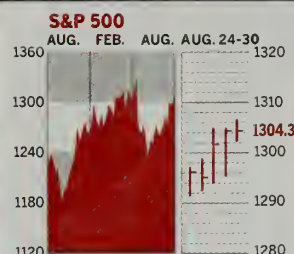


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### STOCKS

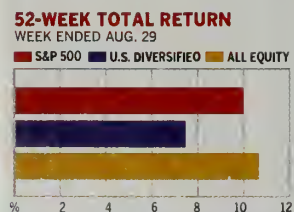
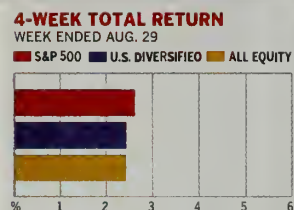


### COMMENTARY

An upward revision to the gross domestic product growth rate and declining oil prices gave a small boost to an otherwise desultory market. Crude oil prices slid below \$70 for the first time in two months. Major indexes finished up slightly higher, with the Dow Jones industrial average rising 0.8%.

Data: Bloomberg Financial Markets, Reuters

### MUTUAL FUNDS



Data: Standard & Poor's

### U.S. MARKETS

|                       | AUG. 30  | WEEK | % CHANGE YEAR TO DATE | % CHANGE LAST 12 MONTHS |
|-----------------------|----------|------|-----------------------|-------------------------|
| S&P 500               | 1304.3   | 0.9  | 4.5                   | 7.9                     |
| Dow Jones Industrials | 11,382.9 | 0.8  | 6.2                   | 9.3                     |
| NASDAQ Composite      | 2185.7   | 2.4  | -0.9                  | 2.6                     |
| S&P MidCap 400        | 746.7    | 1.2  | 1.2                   | 6.6                     |
| S&P SmallCap 600      | 368.8    | 2.2  | 5.2                   | 8.4                     |
| DJ Wilshire 5000      | 13,044.8 | 1.1  | 4.4                   | 8.1                     |

### SECTORS

|                      | AUG. 30 | WEEK | % CHANGE YEAR TO DATE | % CHANGE LAST 12 MONTHS |
|----------------------|---------|------|-----------------------|-------------------------|
| BusinessWeek 50*     | 736.0   | 0.7  | -0.8                  | 1.7                     |
| BW Info Tech 100**   | 391.8   | 2.7  | 3.0                   | 8.5                     |
| S&P/Citigroup Growth | 606.4   | 1.3  | 1.7                   | 4.7                     |
| S&P/Citigroup Value  | 695.7   | 0.4  | 7.4                   | 11.3                    |
| S&P Energy           | 426.4   | -2.0 | 14.4                  | 14.8                    |
| S&P Financials       | 447.2   | 0.1  | 4.9                   | 14.4                    |
| S&P REIT             | 180.7   | 2.2  | 18.1                  | 20.7                    |
| S&P Transportation   | 242.2   | -0.2 | -3.0                  | 13.3                    |
| S&P Utilities        | 173.5   | 0.4  | 8.7                   | 6.5                     |
| GSTI Internet        | 172.9   | 3.4  | -15.7                 | 0.4                     |
| PSE Technology       | 806.7   | 2.4  | -3.5                  | 0.9                     |

\*Mar. 19, 1999=1000 \*\*Feb. 7, 2000=1000

### GLOBAL MARKETS

|                             | AUG. 30  | WEEK | % CHANGE YEAR TO DATE |
|-----------------------------|----------|------|-----------------------|
| S&P Euro Plus (U.S. Dollar) | 1767.3   | 1.9  | 16.9                  |
| London (FT-SE 100)          | 5929.3   | 1.2  | 5.5                   |
| Paris (CAC 40)              | 5182.8   | 2.0  | 9.9                   |
| Frankfurt (DAX)             | 5867.5   | 1.6  | 8.5                   |
| Tokyo (NIKKEI 225)          | 15,872.0 | -1.8 | -1.5                  |
| Hong Kong (Hang Seng)       | 17,284.7 | 1.1  | 16.2                  |
| Toronto (S&P/TSX Composite) | 12,068.4 | -1.0 | 7.1                   |
| Mexico City (IPC)           | 21,331.1 | 2.8  | 19.8                  |

### FUNDAMENTALS

|                                      | AUG. 29 | WEEK AGO |
|--------------------------------------|---------|----------|
| S&P 500 Dividend Yield               | 1.84%   | 1.84%    |
| S&P 500 P/E Ratio (Trailing 12 mos.) | 17.2    | 17.1     |
| S&P 500 P/E Ratio (Next 12 mos.)*    | 14.2    | 14.2     |
| First Call Earnings Revision*        | -0.90%  | -0.95%   |

### TECHNICAL INDICATORS

|                                       | AUG. 29 | WEEK AGO |
|---------------------------------------|---------|----------|
| S&P 500 200-day average               | 1276.1  | 1274.2   |
| Stocks above 200-day average          | 53.0%   | 54.0%    |
| Options: Put/call ratio               | 0.90    | 0.86     |
| Insiders: Vickers NYSE Sell/buy ratio | 3.19    | 2.99     |

### BEST-PERFORMING GROUPS

|                         | LAST MONTH % |                          | LAST 12 MONTHS % |
|-------------------------|--------------|--------------------------|------------------|
| Tires & Rubber          | 27.2         | Agricultural Products    | 84.5             |
| Comptr. Stge. & Perphs. | 14.4         | Steel                    | 71.2             |
| Electric Mfg. Svcs.     | 13.5         | Divsfd. Metals & Mining  | 62.6             |
| Communication Equipment | 13.3         | Fertilizers & Ag. Chems. | 49.8             |
| Food Wholesalers        | 13.2         | Constr. & Engineering    | 44.4             |

### WORST-PERFORMING GROUPS

|                      | LAST MONTH % |                      | LAST 12 MONTHS % |
|----------------------|--------------|----------------------|------------------|
| Wireless Services    | -14.0        | Educational Services |                  |
| Oil & Gas Drilling   | -9.4         | Homebuilding         |                  |
| Personal Products    | -9.3         | Internet Retailers   |                  |
| Oil & Gas Refining   | -9.3         | Spec. Consumer Svcs. |                  |
| Spec. Consumer Svcs. | -8.7         | IT Consulting        |                  |

### EQUITY FUND CATEGORIES

| 4-WEEK TOTAL RETURN     | %    | 52-WEEK TOTAL RETURN     | %    |
|-------------------------|------|--------------------------|------|
| <b>LEADERS</b>          |      | <b>LEADERS</b>           |      |
| Technology              | 7.1  | Precious Metals          | 70.1 |
| Communications          | 4.0  | Latin America            | 49.7 |
| Latin America           | 3.8  | Diversified Emrg. Mkts.  | 32.2 |
| Diversified Emrg. Mkts. | 3.2  | Diversified Pacific/Asia | 26.0 |
| <b>LAGGARDS</b>         |      | <b>LAGGARDS</b>          |      |
| Natural Resources       | -2.4 | Technology               | 4.1  |
| Precious Metals         | -0.6 | Large-cap Growth         | 4.3  |
| Miscellaneous           | 0.9  | Health                   | 4.7  |
| Financial               | 1.0  | Mid-cap Growth           | 5.3  |

### EQUITY FUNDS

| 4-WEEK TOTAL RETURN            | %     | 52-WEEK TOTAL RETURN       | %     |
|--------------------------------|-------|----------------------------|-------|
| <b>LEADERS</b>                 |       | <b>LEADERS</b>             |       |
| ProFunds. Semicdr. Inv.        | 16.2  | U.S. Global Invsr. Gold    | 101.4 |
| DireXn. NASDAQ100 BI 2.5X Inv. | 14.9  | Midas                      | 99.5  |
| Fidelity Sel. Networking       | 13.6  | U.S. Gbl. Invs. Pr. Mnls.  | 92.6  |
| ProFunds Ultra Tech. Inv.      | 13.4  | Van Eck Invsr. Gold A.     | 86.1  |
| <b>LAGGARDS</b>                |       | <b>LAGGARDS</b>            |       |
| Ameritor Investment            | -33.3 | Ameritor Investment        | -81.8 |
| DireXn. NASDAQ100 Br 2.5X Inv. | -13.7 | American Heritage Grth.    | -50   |
| ProFds. Mble. Tlcmms. Inv.     | -13.2 | ProFds. Mble. Tlcmms. Inv. | -22.8 |
| ProFunds UltSh. OTC Inv.       | -10.8 | American Heritage          | -22.2 |

### INTEREST RATES

|                         | AUG. 30 | WEEK AGO |
|-------------------------|---------|----------|
| <b>KEY RATES</b>        |         |          |
| Money Market Funds      | 4.85%   | 4.84%    |
| 90-Day Treasury Bills   | 5.05    | 5.09     |
| 2-Year Treasury Notes   | 4.82    | 4.87     |
| 10-Year Treasury Notes  | 4.76    | 4.81     |
| 30-Year Treasury Bonds  | 4.91    | 4.95     |
| 30-Year Fixed Mortgage† | 6.25    | 6.25     |

### BLOOMBERG MUNI YIELD EQUIVALENTS

| Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate. |             |
|------------------------------------------------------------------------------------------------------|-------------|
|                                                                                                      | 10-YR. BOND |
| General Obligations                                                                                  | 3.89%       |
| Taxable Equivalent                                                                                   | 5.56        |
| Insured Revenue Bonds                                                                                | 3.97        |
| Taxable Equivalent                                                                                   | 5.67        |

## THE WEEK AHEAD

### NONMANUFACTURERS' INDEX

**Wednesday, Sept. 6, 10 a.m. EDT** » The Institute for Supply Management's nonmanufacturing activity index for August is forecast to have held virtually steady at 55%. That's the median forecast of economists surveyed by Action Economics. The July index fell to 54.8%. More nonmanufacturers, consisting mostly of service industries, said they added workers in July.

### BEIGE BOOK

**Wednesday, Sept. 6, 2 p.m. EDT** » The Federal Reserve releases its overview of economic conditions before the Sept. 20 monetary policy meeting. Most economists polled by Action Economics see the Fed holding interest rates at 5.25%.

### INITIAL UNEMPLOYMENT CLAIMS

**Thursday, Sept. 7, 8:30 a.m. EDT** » New filings for state unemployment claims probably edged up to 315,000 in the week

ending Sept. 2, from 313,000 for the week ended Aug. 19.

### INSTALLMENT CREDIT

**Friday, Sept. 8, 3 p.m. EDT** » In July, consumers most likely accrued \$6.3 billion of debt, following a jump of \$10.3 billion in June. Slower vehicle sales have led to a slower pace of growth in consumer credit. In June, nonrevolving credit, made up largely of auto loans, grew just 2.4% from a year ago, the slowest pace since 1993.

The *BusinessWeek* production index eased to 283.9 for the week Aug. 19, a 12.5% improvement year ago. Before calculation four-week moving average, it eased to 283.6.

### BusinessWeek

For the BW50, more investment data, and the components of the production index visit [www.businessweek.com/extras](http://www.businessweek.com/extras)

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# Grand Expectations

**PIANO** The Making of a Steinway Concert Grand

By James Barron; Times Books; 280pp; \$24

For as long as I can remember, I've been a sucker for factory tours. It doesn't really matter much what's being made—silicon chips, chocolate bars, TV sets, cars. It's more the magic of watching workers and machines making finished products out of a collection of mostly unidentifiable parts. As Henry Ford put

it: It's raw materials going in, and cars coming out.

But *Piano: The Making of a Steinway Concert Grand* by James Barron, a staff reporter for *The New York Times* and an accomplished (amateur) pianist, is the first plant tour I've taken in book format. Barron follows a single piano, No. K0862, on its yearlong journey through Steinway & Sons' New York City factory and on to its debut in Steinway's storied concert division, pianos earmarked for loans to artists and institutions. Barron's is a surprisingly rewarding approach, letting your mind's eye flesh out the parts and processes that he describes in words.

The book is special in another way as well. Steinway has resisted automation, so you're witnessing a kind of manufacturing that is rare today. K0862 is largely handmade in the same way that pianos were produced in the last century—and the one before that. Barron describes techniques and tools, often homemade, that you can imagine being passed from father to son, from master to apprentice.

The piano's wooden case is fashioned from 17 maple strips glued together and bent—not by some giant press but with the brute human force of a crew of six men—into the familiar arc of a grand piano. Ante Glavan, a so-called bellyman because to do his job he has to lie on his stomach on the spruce sounding board, carves 88 notches in the wooden bridge to accommodate the piano strings, all without bothering to use a ruler to check his measurements.

If such details make you think that *Piano* could get a bit tedious, well, in other hands it might. But Barron weaves an engaging narrative, and he rounds out the personalities of the workers. He's helped, too, by his subject. For a musical instrument, the piano is easily understood. At a glance you can grasp how all the parts work: pressing a key swings a hammer down on a string, producing a note. Besides which, many boomers, including me, grew up with at least a little hands-on experience—those dreaded piano lessons.

Barron leavens his account with chapters on the waxing

and waning of Steinway's fortunes. He starts with German founder Heinrich Steinweg (the name was changed to Steinway when the family set up shop in New York in the 1850s) building pianofortes in his kitchen in the 1830s. The best of these sections detail the rivalry between the Stein and the first American piano maker, Chickering & Sons. They are delightful stories of the companies' marketing shenanigans, such as the erection of the competing, blatantly commercial Steinway Hall and Chickering Hall in Manhattan long before Carnegie Hall stole the show from both. The constantly angled for artists' endorsements and for awards. That part of the history culminates at the 1876 Centennial

Exposition in Philadelphia, where the Steinways walked off with the grand prize after bribing a judge and, rumor has it, ghostwriting his report.

One shortcoming: Barron fails to give Jonas Chickering full credit for his contributions to piano making, such as use of a cast iron plate to relieve the stress on the wooden piano case and what's called overstringing, positioning the longest bass strings over the others so that they can take advantage of the sounding board's sweet spot. (Full disclosure: I'm an amateur pianist, and the last piano I played regularly was a foot Chickering concert grand similar to the Steinway profiled here.) A casual reader might think those improvements were Steinway's.

The author also details Steinway's slow decline. Piano making in the U.S. peaked in 1905, when more than 400,000 were made; Steinway's best year was 1926, at which point the nation produced 200,000. Somehow, the company couldn't seem to grasp the fact that the instrument was no longer at the center of American social life. The prime living real estate was being taken by technology—first the

phonograph, then the radio, and, finally, TV. Ironically, what would save Steinway was its sale in 1972 to CBS.

Early on in the book, in the spring of 2004, when the K0862 is still a big wooden box, Barron writes: "In the future it will become a musical instrument. First it will become a piece of furniture." The observation underscores a sad reality. Today, over half of all grand pianos sold never get played. The craftsmanship and exertion of Steinway's workers are impressive—but many of their masterpieces will serve more than glorified coffee tables. ■

—By Larry Ar



**The story of one Steinway, from strips of maple to concert piano.**



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# The Trials of Dick Grasso

**FIVE YEARS AGO**, Dick Grasso was celebrated for getting the New York Stock Exchange up and running almost immediately after the attacks of September 11. Today he is about to go to court to defend himself against a lawsuit brought by New York Attorney General Eliot Spitzer alleging that the \$187.5 million pay package Grasso was awarded as head of the Big Board violated a state law requiring that officers of not-for-profit corporations be paid only compensation that is "reasonable." It also alleges that Grasso improperly influenced the amount of his award and that the NYSE board was given incomplete and inaccurate information about the pay package. When I talked with Grasso, he was upbeat but less combative than in the past.

**You won kudos for swiftly getting the Big Board back on its feet right after September 11. Now you're about to go to trial. Any bitterness?**

None whatsoever. The two are completely unrelated. The response to September 11 was the financial-services business and the government sending a message to the terrorists that they had failed. That they had killed thousands of innocent people and destroyed property but that the target of their attack, the fundamental embodiment of America, would shine brighter than ever before.

**Will you settle your case?**

We are way beyond the point of talking about settlement. It is important now for...the world to understand that the level of compensation that I received was agreed upon by the most admired and toughest and most responsible people in business. I never negotiated, and I never

asked for a nickel. They paid me what they thought I des

**Some people might say, sure, the board approved your pay but you basically controlled the board because they were heads of the listed companies that your exchange was regulated. That is absolutely incorrect. If you look at the composition of the board throughout my eight years as chairman and CEO, I suggest that someone like [former Ford CEO] Alex Trotter [former Autodesk CEO] Carol Bartz or [former Goldman CEO] Hank Paulson, today this country's Treasury Secretary, was in any way intimidated by Dick Grasso is perfectly s**

**Would Spitzer have gone after you if he weren't running for governor?**

I don't believe this has anything to do with his gubernatorial bid. The Attorney General was presented with a request [interim NYSE Chairman] John Reed to bring this action. I was given copies of a report that has been substantially

diated.... He was misled, and I think the case is mismanaged. The rhetoric on both sides has been unfortunate.

**Any hard feelings toward Paulson? He first gave you high marks and then was instrumental in pushing you out and installing his former Goldman colleague John Thain.**

No. Hank was a very tough, fair-minded person. I don't know what the exchange paid me when I was a member of the compensation committee, but my call for my removal was a reflection of his opinion at that point in time. There was no malice.... I can understand why he chose to do what he did.

**Do you regret not taking the NYSE public when you had the chance?**

Well, I do. It's very difficult to compare 1999 to today, but had we taken it public in 1999, this issue would have never arisen. I learned early on Wall Street that the tape only runs in one direction. You can't make it go backwards.

*Maria Bartiromo is the anchor of CNBC's Closing Bell.*





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# Ideas **The Welch Way**

BY JACK AND SUZY WELCH

## How to Be a Talent Magnet

**What are the three most critical factors that turn a company into a preferred employer? And what's a realistic time frame for getting there?**

—Anonymous, Chicago

You ask for three factors, but you need twice that many “gold stars” to earn the grand prize of being a preferred employer. And it is a grand prize, because when you build a company where people really want to work, you’ve got your hands on one of the most powerful competitive advantages in the game: the ability to hire and field the best team.

But before we give you our six steps to arriving at that fortunate place, let’s talk about how long it takes to become a preferred employer.

The answer is: years. And it can be decades or more. That’s just the way it is with corporate reputations. They’re built annual report by annual report, career by career, crisis by crisis (because every company has one or two of them), and recovery by recovery. It took IBM about 30 years to earn its gold-standard reputation in the 1970s, less than a decade to stumble and lose it, and probably a decade more to rebuild to where it is today.

In today’s media-saturated world, however, there is a major exception to the generally slow pace of reputation-building. Companies can become preferred employers virtually overnight thanks to the “buzz factor,” which is as potent as it is fast-acting. In a technology-based company, buzz usually comes with an exciting breakthrough or paradigm-altering product or service. Google, eBay, and Apple are perfect examples. Buzz, however, can also come from having a glamorous or prestigious brand, like Chanel or Ferrari.

But the buzz factor is as rare as it is precarious. Apple had it with the Mac, lost it when other PC makers leapfrogged ahead of the company, then recaptured it (plus some) with the iPod. This entirely common story explains why most companies have to achieve preferred employer status the old-fashioned way, grinding it out over time. Here’s a checklist to assess your company’s progress:

1. Preferred employers demonstrate a real commitment to continuous learning. No lip service. These companies invest in the development of their people through classes, training programs, and off-site experiences, all sending the message that the organization is eager to facilitate a steady path to personal growth.

2. Preferred employers are meritocracies. Pay and

promotions are tightly linked to performance, and rigorous appraisal systems consistently make people aware of where they stand. As at every company, the people you know at school you went to might help get you in the door. But at that, it’s all about results. Now, why does all this make a company a preferred employer? Very simply, because people with brains, self-confidence, and competitive spirit are attracted to such environments.

3. Preferred employers not only allow people to take risks but also celebrate those who do. And they don’t shoot the messenger who try but fail. As with meritocracies, a culture of risk-taking attracts exactly the kind of creative, bold employees companies want and need in a global marketplace where innovation is the single best defense against unrelenting cost competition.

4. Preferred employers understand that what is good for society is also good for business. Gender, race, and national origin are never limitations; everyone’s ideas matter. Preferred employers are diverse and global in their outlook and environmentally sensitive in their practices. They offer flexibility in work schedules to those who earn it with

performance. In a word, preferred companies are enlightened.

5. Preferred employers keep their hiring standards tight. They make candidates work hard to join the ranks by meeting strict criteria that center around intelligence and previous experience and by undergoing an arduous interview process. Admittedly, this factor is somewhat of a catch-22 since it’s difficult to be picky before you become an employer of choice. But it’s worth the effort. Talent has an unlimited way of attracting other talent.

6. Preferred companies are profitable and growing. A rising stock price is a hiring and retention magnet. But beyond that, only the best companies can promise you a future with

mobility and the potential of increased financial reward. Indeed, one of the most intoxicating things a company can offer to a potential employee is: “Join us for the ride of your life.”

As we said at the outset, the best thing about being a preferred employer is that it gets you good people, and it launches a virtuous cycle. The best team attracts the best team, and winning often leads to more winning. That’s the beauty of it: that you and your employees will never want to get off

*Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at [thewelchway@businessweek.com](mailto:thewelchway@businessweek.com). For their weekly podcast, go to [www.businessweek.com/search/podcasting.htm](http://www.businessweek.com/search/podcasting.htm).*



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# 64

## GET A (WORK) LIFE

Jumping into the job market? Our new rankings can guide you toward the best places to start a career



## Cover Story

### 64 Best Places To Launch a Career

Like baby boomers, a new generation is reshaping the U.S. workplace. Tech-savvy and achievement-oriented these hires are eager for feedback and impatient to get ahead. They thrive on teamwork. Employers like Disney and Lockheed Martin are scrambling to adapt—and that's put them on top of *BusinessWeek's* first-ever list of the top 50 places to start your work li

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## The Population Boon

As big, round figures go, this one is pretty remarkable: The U.S. population is expected to hit **300 million** this October. In a BusinessWeek.com Special Report, we explore the implications—and the opportunities—presented by this milestone. First, *BusinessWeek's* chief economist Michael Mandel tells **why size matters** when it comes to building a leading global economy, and finds it's no coincidence that the U.S., the most innovative major industrialized country, also has the fastest-growing population and the most young people. Next, we tackle what rapid growth means for investors with a list of **five smart stocks** poised to benefit from key demographic shifts. Finally, we offer two slide shows illuminating the nation's journey to 300 million. One provides fascinating snapshots of the country as it grew from its agrarian roots to the high-tech diversified economy of today. The other examines **10 key innovations**, great and small, that helped foster the growth and settlement of the nation. Our report shows that no matter the era, growth—and change—is a constant of the American experience. [www.businessweek.com/go/06population](http://www.businessweek.com/go/06population)

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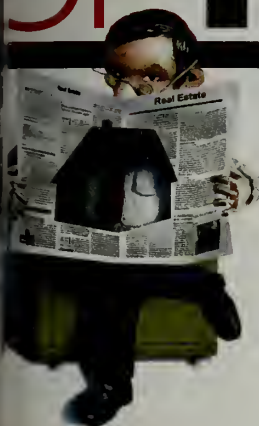


**verizon**business

# JP Front

"Alan knows what it's like to have your back to the wall—and fight your way out with a well-conceived plan and great execution."

—Bill Ford on Boeing exec—and new Ford CEO—  
Alan Mulally in a note to employees



EDITED BY  
DEBORAH STEAD

## REAL ESTATE ADS FOLLOW HOME BUYERS TO THE WEB

**NEWSPAPERS** hardly need more bad news, but the housing bust may deliver it anyway. Three new studies say the \$11 billion real estate market is set to shift from print to the Web. Most home buyers hunt online now, and print ads are relatively pricey for newly tight-tightening brokers. "In 2007, I'll spend 50% less on the newspaper," says Bob Lurie, president of **Edina Realty**, Minnesota's top broker. Already, he's cut ads in the Twin Cities' two papers

from three pages to one.

For now, as some agents buy everywhere to spur sales, realty ads in dailies are up 19% for the second quarter, says the **Newspaper Association of America**. But investment bank **Piper Jaffray** and consultants **Classified Intelligence** and **Borrell Associates** say that won't last. Gordon Borrell, the latter's president, says Web ad sales, now 15% to 20% of the market, will top newspapers' share (now at 37%) by 2010, when papers will lose "at least seven points."

Papers are fighting back. A joint venture of companies **Belo**, **Gannett**, **Tribune**, **McClatchy**, and **Washington Post** has built up sites like **Apartments.com** and appraisal site **HomeGain.com**. And the papers' sites are expanding their real estate sections. The question is less whether home ads will move online than how fast—and whether newspaper sites can keep a share. —*Timothy J. Mullaney*



STEINEM  
AND FONDA:  
Lower-decibel  
discussions

## THE AIRWAVES

# Talk Radio Minus The Testosterone

**FEMINIST ICONS** Gloria Steinem and Jane Fonda are launching a talk radio network aimed at women. **GreenStone Media** (from *Finding the Green Stone* by Alice Walker) will debut on Sept. 12 on at least a few AM stations and online, with more AM and FM stations to follow. "Women are more and more turned off by the hostility and argumentative nature of AM talk radio," says Steinem, who says GreenStone will offer lower-decibel discussions, including segments on health and child-rearing, along with comedy and hosts such as actress Mo'Nique.

GreenStone, whose backers include Rosie O'Donnell and *Friends* co-creator Marta Kauffman, may be on to something. **Arbitron** reports that the amount of time women ages 25 to 54 spend listening to the radio has fallen more than 10% since 1999. And both **Sirius** and **XM** have had success with the genre. (Sirius offers *Martha and Cosmo*, both 24/7 channels. XM, which will launch *Oprah & Friends* on Sept. 25, already has *Take Five*, which excerpts audio from TV talk shows, including *The Ellen DeGeneres Show*.)

Advertisers like talk radio because the audience tends to stick around during the commercial breaks, says Michael Harrison, publisher of *Talkers*, an industry journal. Still, newcomers such as GreenStone may find it tough to land radio contracts. "The large, corporate-owned commercial broadcasters have very low tolerance for risk," Harrison says. And because it's new, "women's talk radio is considered high risk." Stay tuned.

—*Toddi Gutner*

## THE BIG PICTURE

**AS MULTINATIONALS** operating in China compete fiercely for talent, a Manpower survey shows why retaining local managers remains an issue:

|                                                                                          |     |
|------------------------------------------------------------------------------------------|-----|
| For professionals who believe Chinese employees quit mainly to seek better pay           | 70% |
| Chinese employees who say lack of career opportunities is the key reason they leave jobs | 68% |
| Chinese employees who feel their company offers sufficient career development            | 33% |

Source: Manpower Inc. survey of 141 HR executives at companies doing business primarily in Shanghai, Beijing, and Hangzhou and 312 candidates interviewed in those cities



## PLACE YOUR BETS GAME, SET, AND MATH

**ATTENTION**, sports fans: This time next year, you may be settling your bar bets on the U.S. Open more quickly.

New statistics software created by Jan Vecer, a Columbia University statistics professor and tennis fan, is designed to predict the winner of a match early on.

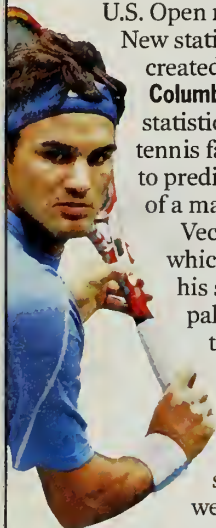
Vecer's program—which arose from his search for a palatable way to teach

statistics—measures the importance of each point scored, weighting points accordingly in predicting the

odds of who will win game, set, and match. As a contest progresses, the model recalculates the odds.

Columbia's business incubator, Columbia University Science & Technology Ventures, is helping Vecer market the software for sportscasters, coaches, and fans to use on a variety of electronic devices. The model has also been noticed by several betting operations for sports such as soccer, basketball, and hockey, which are drawing ever-larger numbers of gamblers wagering on the outcome of an entire season. Vecer says he will open his own company to serve this market, since Columbia does not want to be associated with gambling.

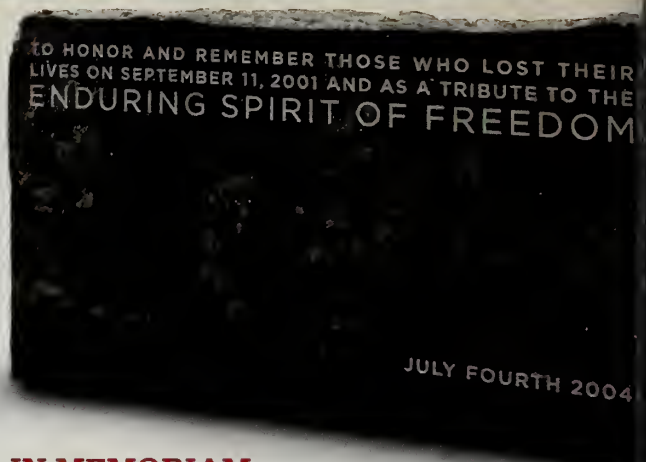
Meanwhile, he'll keep busy with academic pursuits, using his new model in a class that's popular with Columbia students: Statistics in Sports. —Aili McConnon



FEDERER

## TRENDSPOTTING RISING SONS

» **JAPAN'S PRINCESS** Kiko gave birth on Sept. 6 to the first male heir to the throne in decades. In the past, the arrival of a new royal has triggered baby boomlets, since many Japanese think it auspicious to have a child born in the same year as a member of the imperial family. Anticipating more births, investors drove up shares of baby-food maker **Pigeon** (up 45% from early June to early September) and stroller maker **Combi** (up 27%). As for the impact on Japan's population decline, "I doubt a temporary rise in the birth rate could reverse the downtrend," says Akihiko Matsutani, professor at the **National Graduate Institute for Policy Studies** in Tokyo. —Kenji Hall



## IN MEMORIAM

**ADD TO THE LIST** of makeshift and poignant September 11 memorials the backyard of Innovative Stone, a supplier of natural stone based in Hauppauge, N.Y. That's the current home of the **Freedom Stone**, a 20-ton, 5-ft.-tall polished slab of granite dedicated to those who died in the attack. The piece, donated by Innovative Stone founder and CEO Karen Pearse, is to be the cornerstone of the Freedom Tower in lower Manhattan, and it has attracted a word-of-mouth following. About 10 to 15 people a week visit the stone, some leaving flowers, Pearse says. And until the stone is finally transported to Ground Zero, "it's available for whoever wants and needs to see it." —Elizabeth Woy

## DRAWN & QUARTERED







## SOFTWARE



## DISASTER MANAGEMENT 101

It's a pity that former FEMA director Michael Brown hadn't logged a few hours on a disaster simulation computer program before Hurricane Katrina struck. The Justice Dept. is now sending out just such a program to 40,000 municipalities nationwide.

**Incident Commander**, a program made by Hunt Valley (Md.) software company **BreakAway**, has already proved itself in the field. One of Katrina's first responders, Joseph Barlow, used what he had learned from a test version to help set up an 800-bed field hospital in Baton Rouge. A paramedic from rural Illinois who had never supervised anyone before, Barlow drew on Incident Commander's step-by-step approach to disaster management to run logistics for the hospital, which treated 6,000 patients. It was "an excellent example of training becoming reality," says Glenn Schmitt, acting director of the Justice Dept.'s National Institute of Justice. BreakAway will release a version that will support live drills in 2007.

—Steve Hamm

## PRODUCT PEEK

## HOW GREEN ARE MY BLUE JEANS

**LEVI STRAUSS** will debut more than a new CEO when current COO John Anderson takes over in November. The company will also introduce Eco jeans, its first organic-cotton line. The target customers: upscale shoppers, the kind of eco-consumers for whom price (\$250) will be less important than the tag it's printed on (recycled paper, soy ink).

Levi's will launch the naturally dyed "green" jeans, handcrafted in the U.S., in select Levi's stores. In early 2007 the company will roll out cheaper versions—\$65 to \$80—in department stores, followed by jeans costing \$40 to \$60 in the fall. The cotton used in those styles (to be made "all over the world," according to

spokeswoman Amy Jasmer) will not be as pure as that used in the initial Eco line, says Robert Hanson, Levi's U.S. brand president. Organic cotton, he says, is still too rare to be used alone in mass amounts of clothing, hence the high cost of the first Eco batch.

Why dress in organic denim? After all, synthetic threads and dyes don't pose the same potential health risks as pesticides in foods, says Rebecca Calahan Klein, president of the nonprofit advocacy group **Organic Exchange**. For eco-conscious

customers, it may just be a matter of supporting farmers who grow pesticide-free crops. (The USDA has set an organic clothing standard, although cotton a crop that could qualify.) Meanwhile, the trend is getting hot. According to Organic Exchange, demand for organic cotton by clothing makers is increasing at an annual rate of 93%.

—Reena J

color look. And that issue, devoted to the "Joys of Country Living," is available on newsstands instead of just by mail.

**Grit's** readership has dwindled from a high of 1.5 million subscribers in 1969 to about 90,000 today, with an average reader age of over 65. That's why the publisher, Bryan Welch, head of **Ogden Publications** in Topeka, Kan., wants to reach out to exurbanites and modern rural residents, folks apt to work in an office during the week and tool around on a small tractor on weekends.

"It's still a magazine about the rural lifestyle, but there's much more about hobby farming," he says.

The staples will remain. The glossy version still celebrates small-town feed stores, praises the tick-controlling power of guinea hens, and gives advice about raising healthy, rodent-catching barn cats. But it has excerpted *The \$64 Tomato*, by William Alexander, a wry book about an idealistic organic farmer's discovery that gardening is "a very expensive sport." Much of the magazine's content is available on [www.grit.com](http://www.grit.com) (where you can also download barnyard sounds as ringtones). Welch says newsstand distributors have already ordered 65,000 copies of the new **Grit**, which comes out bimonthly instead of monthly.

—Joseph W

## AG NOTES GIVING SOME GLAMOUR TO GRIT

**THE FARM SET** just isn't what it used to be. **Grit** magazine, a 124-year-old staple of rural America, has spiffed itself up to snare new readers. Forget the newsprint format that long marked the iconic farmland journal. As of its September/October issue, **Grit** has a glossy four-



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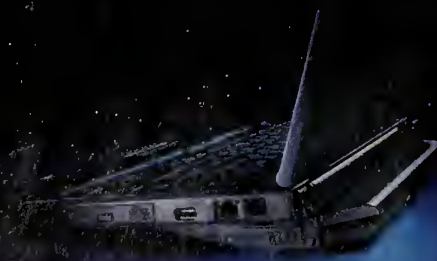
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## SHOWBIZ

### NEW MEXICO BANKS ON THE BOX OFFICE

WHEN THE MOVIE *Employee of the Month*, starring Jessica Simpson and standup comic Dane Cook as Costco workers, hits theaters this fall, producer Lionsgate won't be the only one obsessing over opening weekend receipts. So will the state of New Mexico.

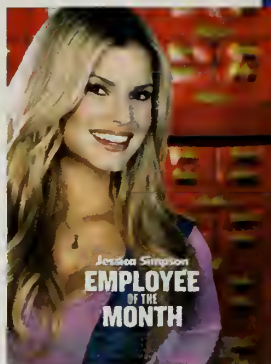
In a novel twist on private-equity investing, the state's \$4 billion Severance Tax Permanent Fund, which supports the public education system, has extended \$130 million in financing to films shot in New Mexico, with more on the way.

Like other public investment funds, New Mexico's is after better returns. So it's aiming to put about 20% of its assets into so-called alternative investments. That term usually refers to private equity and hedge funds. But in New Mexico's case, the

category includes *Employee of the Month*, which the state bankrolled to the tune of \$13 million, as well as a slate of "soft-R" horror movies such as *Living Hell* and *Buried Alive*.

So far, the endowment has managed only to break even. An early venture, *Elvis Has Left the Building*, a 2004 comedy in which Kim Basinger plays a cosmetics saleswoman accused of killing Elvis impersonators, went straight to DVD.

Don't think New Mexico's investment approach is a case of *l'art pour l'art*, though. Greg Kulka, director of private equity and economically targeted investments at the New Mexico State Investment Council, compares the film financing to a mix of "early-stage venture capital" and Treasuries. The state is providing filmmakers with loans that are guaranteed by



industry. (In the past two years, filmmakers spent almost \$98 million in the state, including pay for almost 2,100 crew jobs.) Since 2005 the state has allowed the endowment

lend up to \$15 million to film project, up from \$7.5 million. And the coming attractions from Tinsel Taos? Well, after getting pitched by an independent film producer, the endowment's private equity investment advisory panel is quite keen on horror flicks. They're famously cheap to make, and right now they're hot, bringing

investment-grade banks,

which reduces the risk greatly. And a couple of big hits, insists Kulka, could make up for the duds in the portfolio: "We are 99.9% sure of getting our principal back," he says.

New Mexico has been raising the movie stakes of late, in part to spur a cottage

in twice the annual revenue they did three years ago.

Due out next year, *Want Undead or Alive*. Scripted by South Park writer, it was presented to the council as "*Blazing Saddles* meets *Shaun of the Dead*," according to minutes from the meeting. Says Kulka: "personally have high hopes."

—Emily Thornton

## QUESTION OF THE WEEK

Amid the stock option backdating scandals, some economists are urging the SEC to rescind its 2005 ruling that options must be expensed. They say options aren't a company cost but a way stockholders share future gains with employees. Would repeal make sense—or more mischief?

—David Henry and Peter Coy

"Options shouldn't be expensed. But full disclosure is needed—a table showing investors the potential earnings dilution of the options at different stock prices. It shouldn't be scattered in the footnotes."

Harry Markowitz,  
Nobel Prize-winning economist,  
University of California at San Diego

"People who oppose expensing options say it will be the end of Silicon Valley as we know it. My main concern is that the information be out there so it can be evaluated. I don't get wildly exercised about it."

William Sharpe,  
Nobel Prize-winning economist,  
Stanford business school

"There is no mystery, economic or otherwise: Stock options are a form of compensation. Compensation is part of a company's costs. Cost should be expensed."

Rebecca McEnally,  
director of the Capital Markets  
Policy Group, CFA Center for  
Financial Market Integrity







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# Ready for Liftoff?

**THIS WEEK WE UNVEIL** "Best Places to Launch a Career," a new feature for young college grads. The ranking, a major expansion of *BusinessWeek's* Best B-Schools coverage, couldn't be more timely or useful. Some 1.4 million college graduates are entering the workforce this year, and many have no clear destination in mind. Our analysis, the most comprehensive of its kind, sifts feedback from students, college career counselors, and the employers themselves to reveal which companies offer the biggest advantages for entry-level employees, such as the highest pay, the most rapid advancement, and the best training programs.

The resulting list of 50 top companies (page 64) is a road map for the Echo Boomers—sometimes called the Millennial Generation—as they take off on the biggest trip of their lives: their careers. This group, 80 million strong, born between 1982 and 2000, is a generation unlike any other. If the eldest of them are any indication, they're skeptical, picky, and restless. And more than some previous generations, they want employers who will respect their ideals and give them a chance to make a real impact.

In her Cover Story, Staff Editor Lindsey Gerdes explores some of the workplace changes being triggered by the first wave of Millennials to enter the

workforce. The story is required reading not only for young job seeker but for those who do the hiring. To attract and retain this new

generation, employers may need to throw out the old recruiting playbook and start fresh.

Under the direction of Associate Editor Louis Lavelle, the Best Places team also has created a robust new subchannel at *BusinessWeek.com*. There you'll find profiles of each employer, slide shows, tips on avoiding first-year mistakes, interactive tools, and a video roundtable with recruiters from top companies. Tune in to *BusinessWeek Weekend* (check your local TV listings to find out why some of the top Wall Street firms think the best job candidates are former college athletes). We hope you find it all useful and enlightening.

*Stephen J. Adler*  
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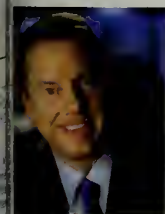
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# ReadersReport

“Will... winners... continue to reap the spoils of their victories at the expense of the greater good?”

—James Guy  
Dublin, N.H.



ion as governments, as well as corpora and individual winners, continue to reap the spoils of their victories at the expense of the greater good?

—James Guy  
Dublin, N.H.

## MISSING FROM THE POLL: THE INFO-TECH TEAM

OVERALL, I AM in complete agreement with everything in The Competition Issue, especially the idea that “you are your own greatest competitor.” However, I was saddened by the “The Poll,” specifically question 19, which asked: “Which part of the company has the most competitive employees?”

Noticeably absent was information technology. Is this because IT employees were not polled, their competitive scores were so low that they did not make the cut, or because they are not considered to be part of the company?

As an IT executive, I feel the progress made in technology is driven by the nature of technologists to compete with themselves and their peers to create better products and to constantly improve.

—Jerry Laws  
Bristow, Va.

## KUDOS FOR COMPETITION —BUT DON'T FORGET ITS DOWNSIDE

THE COMPETITION ISSUE (Aug. 21/28) was the finest I can remember in the 50-plus years I have been a reader, and then a subscriber, to *BusinessWeek*. I could not put it down. It reminded me of reading a Peter Drucker book for the first time—so much information and so many insights that I read it with the intention of immediately reading it again. I knew I could not have possibly grasped all it had to offer.

—C.B. Royal  
Madison, Wis.

which you showed in spades throughout the issue, including disciplines in and out of business.

—Jack Weber  
Oxnard, Calif.

THE COMPETITION ISSUE was intriguing and inspiring. The benefits of competition are thoroughly discussed in a positive way; however, there was only brief mention of the downside. The negative aspects of competition can result in scandals, wars, and other catastrophic man-made events. One only has to read the daily newspaper or watch the nightly TV news to see the manifestation of unbridled competition.

Will we compete ourselves into obliv-

THE NEXUS OF competition and winning is innovation and creativity, both of

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OP COMPETITORS prepare with gusto and perform with virtuosity. They avoid the obnoxious behaviors in *Business Week's* survey.

—Chuck Carroll  
Walnut Creek, Calif.

### PERSONAL BEST: QUANTS, CHIMPS, ANTS, AND DONALD TRUMP

AS A MANAGING director at D.E. Shaw, and I want to attempt to correct a few misunderstandings a reader might have on the basis of your article "The quintessential quant" (The Competition Issue, Aug. 21/28). While your focus is solely on our quantitative hiring practices, D.E. Shaw is an extremely active recruiter of extraordinary talent from nonquantitative fields as disparate as liberal arts, investment banking, accounting, and law. (I was an undergraduate Russian Studies major.) Our recruiting group is engaged in the pursuit of potential superstars, be they technical or otherwise.

Second, while standardized academic test results may be a consideration in D.E. Shaw's recruiting process, there is no particular minimum score required, as was suggested in your article. I landed my job here with a sub-800 math SAT.

Last and most important, although our interview process is indeed rigorous, we have consciously fostered a highly collegial work environment, an impression one might not have gotten from the (understandable) focus on recruiting. And the job interviews are not intended to be adversarial. Many candidates, even unsuccessful ones, have let us know that the interview process is enjoyable, a sentiment we would agree with.

—Trey Beck  
D.E. Shaw & Co.  
New York

"SOCIAL AWKWARDNESS" and "unattractive presentation of self" appear to me to be quite common among rock stars, jocks, hippies, artists, lawyers, accountants, perhaps even surgeons, not to mention morticians, garbagemen, illegal immigrant dishwashers, riders of the New York subways, and certain journalists and authors. Why is it considered permissible to insult the mathematically gifted when it is not permissible to insult so many other groups, elite or otherwise? Do mathematicians need an anti-defamation league, too?

—Stephen Elliott  
Weston, Conn.

I ENJOYED Catherine Arnst's "Selfish genes and mellow monkeys" (The Competition Issue, Aug. 21/28). Her conclusion that "culture can trump our genetic imperative to compete—or at least get us to stop stealing each other's food" offers hope for all of us Type A personalities.

However, given that your survey placed "The Donald" at the top of the list of the most competitive businesspersons in America, do you think there is any possibility that our culture could someday "trump" Trump?

—Dewey E. Ray  
Alpharetta, Ga.

IT IS TRUE that chimpanzees and baboons will make coordinated attacks on rival troops. However, your article failed to mention another animal group, besides man, that engages in organized warfare against its own kind: ants.

—Thomas W. Culliney, Entomologist  
U.S. Agriculture Dept.  
Raleigh, N.C.

AS I EXAMINED the article "A boot camp for budding virtuosos" (The Competition Issue, Aug. 21/28), I realized there was no mention of these youngsters having any



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# ReadersReport

fun, as do their counterparts half a continent away at a similar rustic abode near Estes Park, Colo. Rocky Ridge Music Center provides opportunities galore for its 150 or so campers to practice music, interact, and commune with nature.

After reading each story, thousands of words and hundreds of interviews on every aspect of competition in the special double issue, I realized there were only two passing references to fun: one related to evolution being "clever" enough to make eating fun and the other related to the value of fun urban centers. Frankly, I don't know whether I should laugh or cry at the virtual omission of fun's critical importance to competitive success. Sadly, it must reflect U.S. society, as well as competitive societies around the world.

—Robert M. Berzok  
Stephentown, N.Y.

Editor's note: The writer, retired director of corporate communications at Union Carbide Corp., is a member of the Rocky Ridge Music Center board of trustees.

## PLACES TO BEAT: PORTLAND MAY NOT BE SUCH A GREAT PLACE TO WORK

"SLICKER CITIES" extolled the ambience of Portland, Ore., as a lure for young col-

lege graduates. Unfortunately, most of them will have to commute out of Portland and Multnomah County to Washington County, Clackamas County, and Vancouver, Wash., for well-paying jobs.

Why? Many old-line Portland businesses, such as Columbia Sportswear and Louisiana-Pacific, have left the city and county, and no new ones of any size are moving in. This is because of the area's high tax structure, well-known anti-business attitude, and incompetent government. Portland is truly an ephemeral city.

—Nelson Olf  
Forest Grove, Ore.

## MINUTEMEN, VIGILANTES, AND THE WIDE GULF OVER ILLEGAL WORKERS

IN YOUR ARTICLE "If we can take one big employer down..." (News & Insights, Aug. 21/28), you mistook Dutch Farms Inc. for Cook County Cookers—a company that has no relationship with Dutch Farms except that it is its neighbor. The Minutemen group did not protest Dutch Farms. Dutch Farms does not hire, and has never been accused of hiring, illegal workers. The Minutemen, working together with a local group, African Amer-

icans Against Illegal Immigration, rected their protest to Cook County Cookers. Dutch Farms actually facilitated a mediation session enabling the Minutemen group to voice their concerns face-to-face with Cook County Cookers management. We appreciate *Business Week* granting us the opportunity to the record straight.

—Brian Boomsma, President  
Dutch Farms Inc.  
Chicago, Ill.

Editor's note: The letter was also signed by Anthony Williams, a member of African Americans Against Illegal Immigration.

PRESIDENT GEORGE W. BUSH and Border Angels founder Enrique Morones are wrong about the Minutemen being vigilantes. Vigilantes take the law into their own hands. Minutemen are not breaking the law—they are asking the federal government to enforce it. Illegal aliens are those who hire them are breaking the law.

The way to deal with this situation is to deport anyone who is here illegally and fine and/or imprison those who hire them.

—Randle C. S. S. S.  
Huntington Beach, Calif.

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THEY CALL THEMSELVES Minutemen, but they act more like the Ku Klux Klan. What they claim is a patriotic desire to serve the best interests of our country is in fact an attempt to get the rest of us to subsidize their inability to compete with more cost-effective foreign labor. It is in America's best interest to pay lower labor costs, thereby freeing up resources to use elsewhere in the economy. Why laborers come to our country to provide valuable services, and we should welcome that. The best solution to the large number of undocumented immigrant workers is simply to document them. They make businesses more efficient, so we should make it easier for them to obtain worker's permits. As for those employers whose businesses can't compete, they're the ones who will benefit most by being able to hire cheaper labor.

—Cliff Clive  
Yorktown, N.Y.

THE REASON ILLEGALS are in this country is because they are needed. The American consumer supports their employment with demands for low-cost goods and services. I dare say the entire housing boom, which has been the driving force of

America's gross national product for the past several years, would not have been possible without illegal workers.

The situation is similar to our addiction to low-cost oil. Illegals are an integral part of the U.S. economy. The idea that Americans can fill all these manual labor jobs is not realistic.

As an employer, I would have no problem hiring hard-working, reliable illegal labor if faced with no labor. Other employers who cannot compete can be given the same sympathy as manufacturers that are run out of business by cheap Chinese labor—and that isn't much.

—Ray Santilli  
Oklahoma City

### CHEERS FOR KNICK STEPHON MARBURY'S SNEAKS

MY HAT'S OFF TO Stephon Marbury of the New York Knicks for showing kids that spending \$200 for a pair of sneakers is not a wise buying decision ("Cheap chic," Up Front, Aug. 21/28).

Let's hope this is a first step in rolling back Madison Avenue and Hollywood's brainwashing of young consumers into wanting things they don't need and can't afford. Really smart kids will wear Mar-

bury's \$14.98 shoes and spend the money they save on food, rent... and a college education.

—Steven Bavaria  
Chestnut Ridge, N.Y.

LET'S HOPE others follow Marbury's lead. I'll gladly buy a pair simply to support him.

—Bob Vereen  
Indianapolis

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# BlackBerry's First Stab at Fun

For all the success Research In Motion's BlackBerry handhelds have enjoyed, no one has ever accused them of being either stylish or fun. The new BlackBerry Pearl (\$199 with a two-year contract from T-Mobile) aims to change that. The sleek black Pearl is by far the most attractive design to come from RIM. But it falls short in the fun department.

The Pearl creates a new product category by cramming an alphanumeric keyboard, albeit a cramped and somewhat unusual one, into an amazingly small package. This gives it many of the capabilities of a larger PDA phone, such as a BlackBerry 8700 or Treo 650. At 4 inches long, 2 inches wide, and just over a half-inch thick, the Pearl is substantially smaller than the Motorola Q, which made a splash earlier this year as the most diminutive keyboard-equipped handset, and just a whisker bigger than the Motorola SLVR.

BlackBerrys are basically about e-mail, which is reasonably priced at \$20 a month for unlimited data, in addition to what you pay for your voice plan. But the size of the device forces significant compromises. The right-side scroll wheel that has been a defining characteristic of BlackBerrys has been replaced by a little pearl-like trackball centered below the screen. It took some getting used to, and I found it a bit oversensitive. The 20-key keyboard exploits the SureType system first used on the BlackBerry 7100 series, which means most keys carry two letters. That may sound confusing, but the software predicts with pleasing agility which letter you actually want. The system now imports information from your address book into its dictionary, greatly improving its ability to nail the correct spelling of names.

**STILL, IT'S A CHALLENGE** to type quickly or accurately on a keyboard that is barely 1 3/4 in. wide. In terms of comfort and ease, the Pearl does not compare favorably with the larger Palm Treo, Q, full-size BlackBerry, or BlackBerry 7100. But even a tiny keyboard seems wonderful for entering text when you compare the Pearl to smart phones closer to its size, such as the T-Mobile SDA, equipped only with a 12-button dialpad.

Inside the shiny black and chrome Pearl beats the heart of a BlackBerry. It runs the same basic software as its bigger siblings. And it can sync e-mail, contacts, calendar, and corporate data to the software on your desktop (BlackBerry Enterprise Server) with the reliability and security that



companies and governments have come to know and trust. RIM also gives managers back at the office the option of disabling features they dislike, such as the camera and the ability to store files on removable memory cards. (Both of these may introduce security risks.) In addition, the Pearl can get mail delivered from all manner of standard e-mail accounts, browse the Web, and do everything we expect of a BlackBerry.

**The Pearl's business features remain strong, but the bells and whistles...**

Battery life is excellent, good enough to get you through at least a couple days of heavy e-mail and moderate phone use.

In short, the business features are strong. The Pearl's weakness is in the bells and whistles designed to appeal to consumers. This is the first BlackBerry to incorporate either a camera or a media player. The 1.3-megapixel camera compares favorably with those on most high-end handsets. But the lack of photo-sharing applications, showing up on camera phones

of all sorts are not available for BlackBerry.

The media player is ugly, with an antiquated system for listening to music: You drag music files stored in folders on your computer over to a BlackBerry list—a process that makes you wonder if its designers have ever seen an iPod. The software lacks such basic features as playlists and shuffle and doesn't integrate with iTunes or other such systems. RIM needs to rethink this.

The Pearl is clearly an effort by RIM to make the corporate-oriented BlackBerry more attractive to consumers. I suspect, however, that its main appeal will be to folks in traditional BlackBerry markets who are willing to sacrifice ease of typing for a phone that is smaller, cooler, and more versatile. For them, the Pearl should be an easy winner. ■

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## Media's Master Manipulator

**One danger in thinking about media** too much is reducing everything to The Game. And, to oversimplify what the late *Atlantic Monthly* editor and essayist Michael Kelly said, The Game is simply one of burnishing your own image by getting good press. Of scandals weathered wisely; of years feeding the ever-hungry journalistic pack and escaping with all fingers

intact. When The Game is taken to its extreme by those who work in media and in media-savvy industries like entertainment and politics, good performances at the above equal virtue.

I regret to say that this column is about all of these things. And Angelina Jolie. Actress, U.N. High Commissioner for Refugees Goodwill Ambassador since 2001, adoptive and birth mother, and philanthropist, she's the all-purpose action figure of today's celebrity-industrial complex. Her skills at The Game astonish its harshest judges—the hardened vets of celebrity media. “She really is the new paradigm of how to use your celebrity in ways that benefit everyone involved,” says Larry Hackett, *People's* top editor. Not least of which is herself. It would be churlish to imply that Jolie's extensive charity work is motivated by anything other than sincerity, but it's a crucial element of her increasing celebrity currency and transformation from blood-obsessed tattooed goth to post-punk Mother Teresa.

Also, her boyfriend is Brad Pitt.

### THE TOP FIVE CELEBRITY

magazines sell a combined 5 million copies on newsstands each week, and each week requires fresh meat.

Celebrity media circa 2006 call for more than just glammed-up or dressed-down images. Like any good reality show, they require story lines and character arcs. They need drama and a steady stream of fresh episodes.

One indicator of Jolie's skill at working this system, at overwhelming it with stories so the media don't need to find their own, is how the aftermath of her highly publicized hookup with Pitt played out. The exact



moment of the couple's ignition is not known, but Jolie and Pitt met cute on the set of last summer's blockbuster *Mr. & Mrs. Smith* while Pitt was married to Jennifer Aniston. (And when Jolie was coming off a major box office flop in 2004's *Alexander*.) But in short course the story line “was not ‘I took someone's husband.’ It was ‘I adopt children. I donate [much of] my income,’” says one top tabloid editor. “She is a genius at changing the narrative... How do you hate someone who spent Thanksgiving helping Pakistani earthquake victims?”

Unlike virtually all other celebrities, Jolie does not employ a publicist and in the past year has kept press interviews to a minimum. (She declined to comment for this column.) But the story she presents

**GOTH GIRL TURNED SAINT TURNED...** Jolie's story has a steady stream of new episodes

needs little augmentation. She snagged Pitt, or as one editor puts it, “she usurped the most popular girl.” She had his child, and pregnancies of the stars are the fix and rush of celebrity media. And in

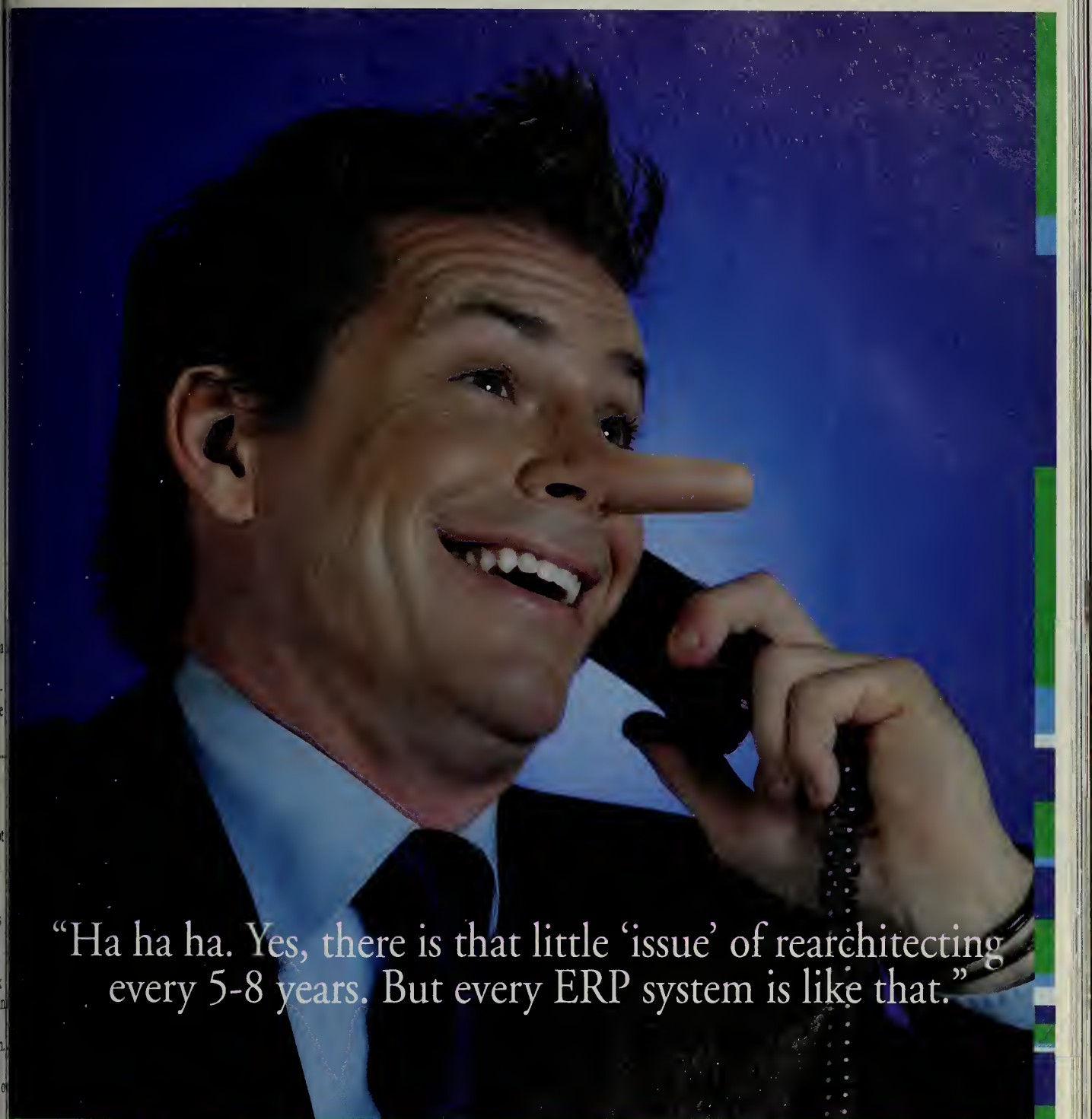
her first post-pregnancy interview with CNN's Anderson Cooper, she said she was already planning her next adoption. (Even postpartum, she scripts the upcoming episode.) The underpinning of her story differs from the fantasies of a life of endless shopping that the tabloids typically sell—not just getting the guy, not just saving the world, but one of utter self-determination. “Women like her. She so does her own thing,” says another top editor, including “crazy [expletive], like having her baby in Namibia. She just does it.”

Paris Hilton got famous by keenly understanding and playing to what tabloids want, but Jolie did something more rare by using them as a springboard to reshape an image. (And, of course, expose fans to causes bigger than herself.) She did this by knowing what makes a celebrity story.

“Honestly, in another life, she could have been a magazine editor,” says Albert Lee, a senior editor at *Us Weekly*. Hey Angelina: If the actress-ambassador thing doesn't work out, there's something for you to fall back on. ■■

**BusinessWeek online** For Jon Fine's blog on media and advertising go to [www.businessweek.com/innovate/FineOnMedia](http://www.businessweek.com/innovate/FineOnMedia)





“Ha ha ha. Yes, there is that little ‘issue’ of rearchitecting every 5-8 years. But every ERP system is like that.”

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<sup>1</sup>SOURCE: Brian Sommer, CEO Techventive and Former Accenture Partner.

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**Sanjiv Ahuja,**  
CEO, Orange



**George Bodenheimer,**  
President, ESPN,  
Inc. and ABC Sports,  
Co-Chairman,  
Disney Media  
Networks



**Beth Comstock,**  
President Digital  
Media and Market  
Development,  
NBC Universal



**Anne Sweeney**  
Co-Chair,  
Disney Media Networks  
and President,  
Disney-ABC  
Television Group



**Harry Sloan**  
Chairman & CEO,  
Metro-Goldwyn-Mayer  
Inc.



**Todd Wagner,**  
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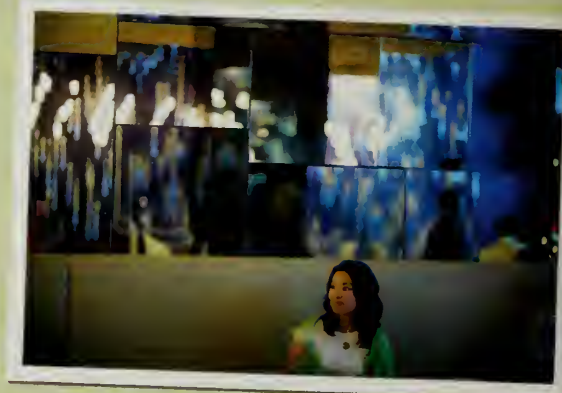
{the perfect green silk scarf - 9.8 minutes}



{a green apple martini - 7.3 minutes}



{the spot to see the green flash - 3.2 minutes}



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A black and white photograph of a park bench. The bench is made of wooden slats and has a dark metal armrest. A dark wallet is lying on the left side of the bench. The background is slightly blurred, showing more of the park and some foliage.

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BY JAMES C. COOPER

# Why the Labor Markets Could Ignite Inflation

Overall compensation costs are soaring, and that could push prices higher

**U.S. ECONOMY** Through the spring and summer, most of the news from the labor markets has been encouraging for the inflation outlook. Job growth has slowed, and the unemployment rate has topped falling. August payrolls increased by 128,000, right on the average monthly gain over the past six months but below the 165,000

mark during 2005. Last month's jobless rate, at 4.7%, remained in the 4.6%-4.8% band it has been in all year after a steady decline. These trends suggest a cooler pace of overall growth that will ease price pressures, and they have been instrumental in giving the Federal Reserve a way to stop hiking interest rates—at least for now.

However, are the inflation signals coming from the labor markets really as benign as they appear? Despite smaller increases in payrolls, the job market remains tight enough to keep pushing up labor costs. Hourly pay for production workers in August, up 3.9% from a year ago for the third month in a row, continued to grow at the fastest pace in five years. More important, a broader quarterly measure of hourly compensation, which covers all workers and other forms of pay such as benefits and bonuses, is growing significantly faster.

In fact, revised data from the Labor Dept. on Sept. 6 show that productivity growth, while very good, is nowhere near fast enough to offset the impact of rising labor costs on businesses. Through the second quarter, updated numbers show productivity, measured as output per hour worked, grew at a healthy 2.5% rate from the same quarter a year ago, but overall hourly compensation is up a steep 7.7% (chart).

That means the labor cost of making a typical unit of output—or unit labor cost—rose 5% over the past year. That pace matches the peak reached in 2000, which was the fastest growth rate since 1990. Historically, unit labor costs have been a key driver of inflation, because speedups, like the current one, increase the pressure on companies to try to cover the added production cost by lifting prices.

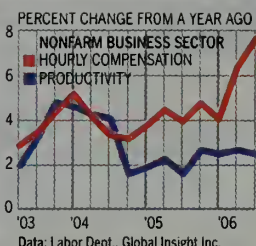
**THE QUESTION** for the inflation outlook is this: To what extent are cost pressures pushing companies to lift their prices in order to support their bottom lines? The answer may not be clear for several more months, as more price data become available. In July, at least, inflation outside of energy and food looked tamer than in previous months. The Fed's preferred gauge rose only 0.1% from June, the smallest monthly gain this year.

Businesses without the pricing power to adjust can only watch as their profit margins shrink, and some bit

of margin squeeze seems to be occurring. However, note that despite the surge in labor costs, earnings last quarter continued to grow strongly. Economywide corporate profits in the second quarter were up a hefty 20.5% from a year ago, the Commerce Dept. reported, the best showing in two years.

One problem is, recent data don't tell a consistent story. For example, a steep acceleration in unit labor costs accompanied at the same time by a speedup in corporate profits is difficult to reconcile. If costs are rising as rapidly as the data say they are, then it's a good bet profit margins of many businesses are getting squeezed. For example, the Sept. 6 report shows

## LABOR COSTS FAR OUTPACE PRODUCTIVITY



prices in the second quarter are up 3.3% from a year ago, far slower than the 5% rise in unit labor costs. It's possible current government data are overstating profits, but earnings reports from individual companies in the Standard & Poor's 500-stock index have been surprisingly robust as well, even excluding energy.

A growing trend that may be helping businesses to cope is the shift toward bonuses in lieu of pay raises, as noted in a recent survey of companies by the human resources firm Hewitt Associates. Bonuses, many of which are paid in the first quarter, may explain part of the 13.7% quarter-to-quarter surge in first-quarter compensation, measured at an annual rate. Greater use of variable pay, which ties pay to performance, limits a company's fixed labor costs, helping profitability and easing the need to lift prices.

**BUT THERE'S ANOTHER, LESS BENIGN** possibility: Overall demand may actually be stronger than the current numbers suggest. If so, many businesses will have more success pushing through price hikes in coming months. That's a premise worth considering,



since the flip side of surging labor costs for businesses is greater income growth for working households.

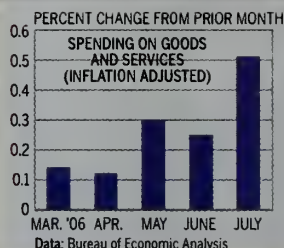
Indeed, the labor markets generated far more income for workers in the first and second quarters than earlier data had shown. In the second quarter, the broadest measure of labor income, including straight pay and benefits, plus bonuses, stock options, and other forms of compensation, grew a revised 8.3% from a year ago (chart). Earlier data had showed it growing an already handsome 6.8%. Labor income has grown more than twice as fast as inflation, which goes a long way toward explaining why consumer spending has been so resilient and why it should remain sturdy in the second half.

The 3.9% rise over the past year in hourly earnings for production and nonsupervisory workers has been eaten up by inflation, a fact much commented on. But the more important gauge for spending is overall income. For this group, about 80% of payrolls, income was up in August by 6.2% from a year ago, based on the combined pattern of both hourly pay and hours worked.

**AGAINST THAT BACKDROP**, the rebound of consumer spending shouldn't be surprising. In July, the broadest gauge of consumer purchases, adjusted for inflation, rose a healthy 0.5% from June (chart). Even with no further rise in August and September, real spending for the quarter would still grow at an annual rate of 3.2% from the second quarter. That means consumers' contribution to economic growth this quarter will be up from last quarter's 2.6% increase.

Consumers also see good news at the gas pump. Gas prices have dropped in recent weeks, and lower wholesale prices promise further declines at the pump in coming weeks. The bulk of the decrease will show up in the September price indexes, which could result in an overall drop in the consumer price index.

## CONSUMERS START THIS QUARTER STRONGLY



Moreover, if gas prices stay down, the overall inflation rate will be much smaller in the fourth quarter than in the third quarter, just as the holiday buying season rolls around. Solid income growth and a smaller bite from overall inflation will give consumers' buying power a sizable boost.

What matters most, though, for the inflation outlook—and for Fed policy—is the trend in prices outside of energy. On that verdict the jury is still out, but the recent evidence from the labor markets on business costs and household income raise a red flag. The Fed noted in the minutes of its Aug. 8 meeting its wish “to accumulate more information before judging whether additional firming [in interest rate policy] would be necessary.” The danger is: While the Fed waits, the labor markets may already be generating new inflation pressures. ■

## JOB TRENDS

# Another Reason To Get That Sheepskin

**FOR AMERICANS** with a college degree, the labor market is far from weak. While overall hiring has settled into a modest pace, the labor market looks quite different depending on a worker's education level. And, based on current economic conditions, the divergence in job prospects according to educational attainment looks as if it may widen further.

The jobless rate for those with at least a bachelor's degree fell to 1.8% in August, from 2.1% in July. The latest level was the lowest since February, 2001. The Labor Dept. survey of households also shows that 57% of new jobs this year among those over 25 years old were filled by highly educated workers, despite their

making up just a third of the workforce. “Education is the best predictor of employment status,” says Wachovia chief economist John Silvia in a Sept. 1 research note.

The strong demand for and limited supply of highly educated workers is translating into accelerating wage growth. The increase in average hourly wages from a year ago in industry sectors with the highest levels of

workers with a bachelor's degree—including finance and insurance, information, and professional services—exceeded the overall yearly rise of 3.9%. Wage growth over the past year was below average in retail trade, manufacturing, construction, and transportation, where

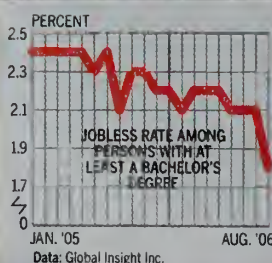
a majority of workers have no more than a high school diploma.

The divergence in labor market conditions could keep widening for the time being. Businesses continue to report a lack of highly skilled workers as a major issue, which means hiring conditions and wage gains should remain positive for better-educated workers.

Despite the solid growth in demand for manufactured goods, demand for some factory workers could keep sliding. U.S. automakers and suppliers are likely to keep cutting payrolls as a way to slash costs. Retailers, particularly department stores, are also cutting back on hiring and the rapid decline in housing means fewer residential construction jobs. As demand weakens for these lower-skill positions, those still employed are also likely to see small wage gains. ■

—By James Mehring in New York

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# The Business Week

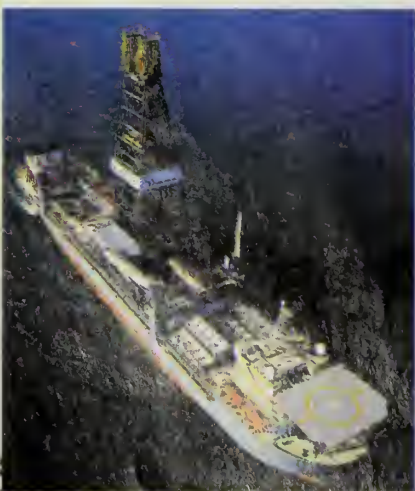
## News you need to know

EDITED BY HARRY MAURER

**Turmoil Times Three** Tremors shook the corridors of power at three major companies. On Sept. 5, **Ford** announced that **Boeing's Alan Mulally** would take over the CEO spot from **William Ford Jr.** (page 30), and **Viacom Chairman Sumner Redstone** booted out his CEO, **Tom Freston**, replacing him with two cronies (page 36). On the same day, **Newsweek.com** revealed a boardroom blowup at **Hewlett-Packard** that led one member, venture capitalist **Tom Perkins**, to quit in May, and will result in another, **George Keyworth**, not being nominated for reelection next March. The **SEC** is looking into the clash (page 35).

**ONLINE** See "Ford's latest recall," "What Freston's departure means for Viacom," and "Perkins goes up against HP—again," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**A Gusher in the Gulf** Want more oil from the Gulf of Mexico? Just keep drilling. **Chevron** and partners **Devon Energy** and **Statoil** on Sept. 5 announced a successful production test of the Jack No. 2 well at the deepest undersea level ever, more



than 20,000 feet, southwest of New Orleans. (The Deep Sea Discovery, photo, drilled the well.) With help from new technology, the well sustained a flow rate of more than 6,000 barrels a day. The news sparked hopes that the U.S. has more black gold than previously figured; oil prices slipped 0.9% that day, to \$68.60 a barrel.

Depending on how other wells develop, the ancient, deep layer of rock could yield 20 billion barrels and boost total U.S. crude reserves by more than 50%. More companies are hunting, including **Anadarko** and **BP**, which said on Aug. 31 that they found hydrocarbons at the Kaskida well in the area.

See "Plenty of oil—just drill deeper," page 38

**Slimmer Intel** It's the classic way to get lean and mean: lay off 10% of the workforce. The world's biggest chipmaker, suffering an inventory glut and with its revenue smashed hard in the bout against **Advanced Micro Devices**, said on Sept. 5 that it would shed 10,500 employees through layoffs, attrition, and business divestitures by the middle of next year. The moves would help save \$3 billion by 2008. Wall Street knocked Intel's battered shares down further the next day after **CEO Paul Otellini** delayed unveiling other restructuring details until mid-October.

**PS3: Don't Hold Your Breath** Sony faces a penalty for delay of game—**PlayStation 3**, to be exact. Already lumbering along nearly a year behind **Microsoft's Xbox 360** console, PS3 won't hit Europe, Australia, and other regions until March, 2007, Sony said on Sept. 6. The reason: a shortage of a key part for its Blu-ray DVD player. Game time in the U.S. and Japan remains set for this November, but consoles will be so scarce that **Microsoft** and **Nintendo** will be cheering. This comes shortly after Sony bore the financial brunt of giant recalls of laptop batteries it made for **Dell** and **Apple**.

**More Metals Mania** To merge or not to merge? That is the question Canada's metals miners are asking themselves as they ponder what to do with all their cash and high stock values. Saying yes are **Goldcorp** and **Glamis**; the two gold miners agreed to an \$8.6 billion deal on Aug. 31. Saying no—at least for now—is **Inco**, which announced on Sept. 5, after months of courtship maneuvers worthy of a Shakespeare comedy, that it won't combine with **Phelps Dodge** after all. The break opens the door, however, for Brazil's **Companhia Vale do Rio Doce**, which bid \$17 billion some weeks back. **Inco** indicated it may now accept **CVRD's** \$17 billion proposal or look for a sexier partner.

**Kiss That \$4 Million Goodbye** A New York judge nixed a plan by **Dana** to pay millions in bonuses to six executives when the auto parts maker motors out of bankruptcy. On Sept. 5, **Judge Burton Lifland** ruled that the bucks amounted to improper retention payments, the first such ruling under a law passed last year. The plan would have awarded **Dana CEO Michael Burns** \$4 million in addition to his regular salary and bonus. **Dana** argued that the payments were legitimate because they were contingent on meeting performance targets.

**Boeing Loses a Big One...** Its **NASA** nickname "Apollo on Steroids," and the **Orion** program—a \$7.5 billion contract for about eight spaceships over the next years—was expected to go to **Boeing**, which operates current **Space Shuttle**. Instead, **Lockheed Martin** got the job on Aug. 31 over **Boeing** and **Northrop Grumman**. The award revives **Lockheed's** flagging space division, which watched **Boeing** grab a number of recent satellite contracts, the **International Space Station**, and a bigger share of the federal and commercial rocket launch biz.



**And Changes Crew** Can **Scott Carson** make planes as  
ll as he sells them? The sales chief who led **Boeing's** team  
record orders in 2005 was named to run its commercial-  
business as former boss **Alan Mulally** heads to **Ford**. His  
challenge is to keep the **787 Dreamliner** taxiing for deliv-  
er in 2008. Getting a new plane airborne can be risky:  
st ask **Charles Champion**, the **Airbus** chief operating officer  
lost his job on Sept. 4 because of production snarls on  
e **A380** megaplane.

**Greenberg vs. Spitzer** For **Hank Greenberg**, it was cause  
celebration—or at least a press release. On Sept. 6 a  
Greenberg spokesman issued a statement that **New York At-  
torney General Eliot Spitzer** had dropped “key charges” in his  
il fraud case against the former **American International**  
oup czar and his ex-CFO, **Howard Smith**. Spitzer  
okesman Marc Violette countered that only minor  
arges were axed, likening the move to demoting Pluto  
t leaving the solar system intact. “All the charges that  
Greenberg and Mr. Smith cooked the books are still  
ere,” he says. “That’s the heart of the case.” While no tri-  
date has been set, the PR tussle is already tense.

**Painkiller for Merck** Capping a 20-month inquiry by  
eam at **Debevoise & Plimpton**, U.S. District Judge **John Martin**  
released a report on Sept. 6 that largely clears the drug-  
aker of malfeasance in its handling of **Vioxx**. Manage-  
ent sincerely believed the drug was safe and had no rea-  
n to think it raised risks of heart attacks, says the report.  
edless to say, lawyers who have filed some of the 14,000  
uits on behalf of **Vioxx** users pointed out that the re-  
rt was commissioned and paid for by **Merck** and there-  
e amounts to little more than a whitewash.

## Wedding of the Week

After sharing quarters for 28  
ears with a friend of his late  
wife, **Warren Buffett** finally tied  
he knot with **Astrid Menks**. The  
billionaire and Menks, a former  
waitress who made sure the no-  
oriously undomestic Buffett's  
clothes were freshly cleaned,  
were wed by a judge on Aug. 30,  
the *Omaha World-Herald* re-  
ported. Felicitously, it was the Sage of Omaha's 76th  
irthday. Buffett met Menks, 60, through his wife, **Susan**,  
who sang at the restaurant where Menks worked.  
Although the Buffetts stayed married until Susan's  
leath in 2004, she left Omaha in 1977, and Menks soon  
ook her place in Buffett's home. “Witty and street-  
mart,” the Latvian immigrant echoed Buffett's style by  
hopping at thrift shops, according to biographer **Roger  
Lowenstein**. Even as Buffett picked up a bride, he's giv-  
ing away most of his \$44 billion fortune to the **Gates  
Foundation**. He's also auctioning his 2001 Lincoln Town  
Car for charity on Sept. 12, complete with his famed  
“FIFTY license plates.



ASTRID AND WARREN

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## EXECUTIVE SUITE

# FORD'S NEW TOP GUN

Alan Mulally helped Boeing reinvent itself in troubled times. But can the plane guy clean up a car wreck as Ford's new CEO?

**BY STANLEY HOLMES, DAVID KILEY, AND DAVID WELCH**

**S**OME KIDS, FROM THE very start, believe they are destined for greatness. Alan R. Mulally was one of them. As a lad in Lawrence, Kan., he sat in the front pew at church, the better to study how the minister revved up the congregation. When he was 17, Mulally considered President John F. Kennedy's call to send Americans to the moon a personal message for him. "I got in front of the TV and said 'I'm ready,'" Mulally once recalled in an interview with *BusinessWeek*. He signed up for extra classes in science, math, and chemistry. He even took flying lessons.

Mulally never made it into orbit. But he found plenty of space to nurture his ambitions at Boeing Co., where he arrived as a junior engineer in a VW Beetle in 1969 and eventually ascended to president and CEO of its fabled commercial airplane division. Now he is taking on a challenge that may be even more daunting than putting a man on the moon: turning around the ailing Ford Motor Co. as its new CEO.

The youthful-looking, enthusiastic, sometimes temperamental 61-year-old executive has not been on anybody's list of hot CEO candidates since the late 1990s, when he was offered top jobs at Raytheon Co. and Teledesic, a failed commercial

satellite company. Nor was Mulally Ford's first choice. Since taking the CEO job himself in late 2001, Chairman William C. Ford Jr. has tried several times to find someone to take it off his hands, going after such industry luminaries as Renault-Nissan CEO Carlos Ghosn and DaimlerChrysler Chairman Dieter Zetsche. The fact that he has had to go outside of the auto world to fill the post raises a profound question: Can a non-car guy fix Ford?

Mulally brings with him knowledge that will be invaluable as he straps on his seat belt at Ford. Boeing is an old-line industrial giant that has endured epic problems and successfully reinvented itself. Mulally has made brilliant product strategy decisions, namely his big bet on the fuel-sipping 787 rather than the gas-guzzlers favored by archrival Airbus. He has experience dealing with unions, though not all of it is positive. He is also something of a turnaround artist. After September 11, he quickly slashed more than 30,000 jobs, closed plants, and kept his unit in the black. And somehow Mulally has managed to spend the last three-and-a-half decades at one of America's most scandal-prone companies without getting much mud on his reputation. "I've been in some tough situations," Mulally told *BusinessWeek*. "I'm here to help a

great company continue to survive.

But the former engineer also has significant gaps in his résumé. It's clear that he's never faced anything like the challenge he'll see at Ford. For starters, this is a much larger company than the division he ran at Boeing—with six times as many employees, eight brands, vs. one, and 110 plants worldwide, vs. six. Boeing launches a new line of airplanes about every 13 years. Ford cranks out new car models every few months. Boeing does almost no consumer marketing while Ford is one of the biggest advertisers in the land. Finance isn't a particular strong suit for Mulally, which is a little worrying at a company bobbing in a sea of red ink. And, finally, he has never had the low public profile typical of auto executives. In anything, Ford's new CEO is averse to limelight and tends to be thin-skinned.

### CURSE OF THE INTERLOPER

AT FORD, MULALLY is going to have to be used to a very hot glare. The company's sales are in free fall, and it has lost \$1.4 billion so far this year—with further losses sure to come. His supporting cast is made up mostly of the same executives who failed to pull the company out of its current tailspin. These people may resent his outsider status and actively try to thwart him. Yet Mulally will have to depend on them





**FRESH PERSPECTIVE**  
As an outsider, Mulally may feel less bound by the industry's old ways.

## Mulally's Marks

He's a manufacturing maestro but has little experience in finance or consumer markets

### MANUFACTURING

**A+**

When Mulally took over Boeing's commercial aircraft division in 1998, it was so troubled that some production ground to a halt, and the company had been forced to post its first annual loss in half a century. By 1999, orders had nearly doubled and operating margins were up fivefold.

### COST-CUTTING

**B+**

Following the September 11 attacks, aircraft orders took a nosedive. Mulally helped Boeing stay in the black by cutting jet production by half. That experience will prove critical at Ford. He was less successful at wringing concessions from Boeing's unions.

### PRODUCT STRATEGY

**B**

Sure, he managed the development of the successful 777 jet and the new 787. But the 777 cost twice the original estimate of \$6 billion. And aerospace is a B-to-B industry with a limited number of products. Creating cars that consumers can love is an entirely different proposition.

### FINANCE

**C-**

Mulally's weakest spot. Ford lost \$1.4 billion in the first half of the year and needs someone who can calm Wall Street and the ratings agencies which have pushed Ford into deep junk territory. But Mulally's relationship with analysts have always been strained, and he has never managed a major merger or acquisition.

while learning the car business on the fly. He'll also have the omnipresent Ford family looking over his shoulder, not to mention the United Auto Workers.

Perhaps even tougher, Mulally will have to break the interloper's curse. Few outsiders get top jobs in the auto business, and Detroit has a nasty way of chewing them up. In the 1990s, brand managers like Bausch & Lomb executive Ronald L. Zarella and a host of other consumers-goods marketers tried to fix General Motors Corp. Ford hired plenty with similar résumés only to see them fail. By 2002, most of them were gone.

Mulally "is not that anchored in the industry. He doesn't even know what he doesn't know," says Jeffrey A. Sonnenfeld, senior associate dean at the Yale School of Management. But his status as an outsider also has some upside. "You're not married to the prevailing models of an industry," Sonnenfeld adds.

By hiring Mulally, however, Ford is getting a manufacturing maestro with few

industrial peers. If there's one thing Mulally is good at, it's taking a broken or underperforming production system, figuring out what's wrong with it, and then making it better than it ever was.

Nothing tested his skills like the production meltdown that nearly sent Boeing crashing to earth in 1997. At the time, the company was trying to boost efficiency on the entire production line, even as it was ramping up to take advantage of a flood of orders. The system collapsed under the strain, costing the company \$2.6 billion and forcing it to post its first annual loss in half a century.

Enter Mulally, who had just been named chief of the commercial aircraft division. He quickly identified the causes: inefficient production techniques, poor supplier relationships, overly ambitious airplane delivery targets, and a culture that encouraged managers to hide problems. Mulally attacked these interrelated problems with a simple plan that had clear productivity targets. Within weeks of his arrival, he gave

airplane production managers responsibility for profit and loss, a first at Boeing. "celebrated every delivery and every production increase," Mulally told *BusinessWeek* in an interview in 2001. By 1999, orders had nearly doubled to 620 planes, and operating margins were up fivefold.

### ENGINEERING A BOUNCE

FORD BADLY NEEDS a manufacturing Mr. Fix-It. The company has the low utilization of its plants of any automaker according to Harbour Consulting. Ford used only 79% of its capacity last year compared with 90% for GM and 94% Chrysler Group, while Toyota ran 106%. Ford also has the dubious distinction of being the least productive automaker in terms of man-hours per vehicle an hour worse than GM and five hours worse than Nissan Motor Co. "Ford not invested in, nor focused on, productivity gains in recent years to the same level as its competitors, and it has cost the company real money," says Ron Harb



ere's one place where Mulally has an opportunity to make shareholders smile.

Mulally's turnaround experience will be critical at Ford. The rebound that he engineered at Boeing's commercial division came to an abrupt halt on September 11, 2001. After orders for new airplanes nose-dived, he swung into action, closing several plants, and renegotiating delivery schedules for some 500 airplanes. As business covered, he kept his unit in the black.

This turnaround experience is going to be critical at Ford, which has botched the restructuring that began under Bill Ford years ago. The company has not acted swiftly enough to cut its head count and get productivity up. Meanwhile, the restructuring blueprint keeps changing. Ford said in January that it would cut at least 25,000 jobs and close 14 plants in North America by 2012. Then Ford last month said it would cut fourth-quarter production by 21% due to falling demand. An announcement speeding up that schedule of closures is expected this month.

Mulally's ability to cut Ford down to the right size is going to depend upon securing cooperation from the UAW. It's a union with a much louder bark and other bite than the International Association of Machinists he worked with at Boeing. Yes, the UAW is a somewhat diminished force. But the union can still make matters ugly for Ford.

Perhaps Mulally has learned something from the strike that shut down many of Boeing's plants for 23 days last year. After all, his hard-nosed bargaining was largely responsible for the stop-

page. In the days before the Machinists walked off the job, Mulally thought he had shrewdly divided the union along generational lines. By offering hefty bonuses and retirement packages, he hoped to entice younger workers to sign on. A similar strategy had worked in 2002. But not this time. Mulally was forced to negotiate a settlement that gave the union most of what it wanted.

With that memory still fresh in labor circles, Mulally will have to tread carefully with the UAW. Ford needs to downsize as fast as it can. Traditionally, the UAW has been cool to drastic job cuts. But the urgency of Ford's situation is apparent to even

militant unionistas. Says David Cole, who runs the Center for Automotive Research: "I'd be surprised if they can't get something very constructive hammered out."

While Mulally has plenty of relevant background in manufacturing and labor relations, he has precious little in finance. At a time of financial crisis, Mulally will have to lean on Ford's financial whizzes, including Kenneth Leet, the former Goldman Sachs banker brought in to consult on asset sales and other strategic financial matters. Not only does Ford need to restore the balance sheet by making tough decisions but the company also requires someone who can calm Wall Street and rating agencies, which have pushed Ford into junk territory. That role doesn't come naturally to Mulally.

## CASH CUSHION

HIS RELATIONS with Wall Street have never been particularly strong. While he has laid off thousands of people, sold off small manufacturing units, and whittled down Boeing's production capacity, Mulally has never negotiated or managed a major merger or acquisition. And when Boeing sold a Wichita plant in 2005, the pressure to do so came from former Boe-



**VITAL ROLE** Bill Ford, as chairman, may be needed to glad-hand a hostile Street

ing CEO Harry Stonecipher, not Mulally.

This is not a moment to shy away from tough financial decisions at Ford. The company lost \$1.4 billion in the first half of the year. And the second half looks to be even worse. With analysts worried about falling sales, expect the bottom line to get pummeled in the second half. Morgan Stanley analyst Himanshu Patel says the cuts will boost losses to Ford's North American business to \$4

billion for the year. The company's North American business alone has already lost \$1.3 billion in the first half of the year.

All eyes are on Ford's cash burn. The company spent \$1.5 billion of its hoard in the first six months of the year. While rating agencies stress that Ford has about \$23.6 billion in cash to cover new-car development, restructuring charges, and retiree costs, the cash drain will only accelerate once the automaker unveils yet another restructuring this month. Ford has already spent \$700 million on separation packages and paid layoff expenses for union workers. Fitch & Co. analyst Mark Oline says that between the added restructuring costs and the operating losses, Ford will burn \$7 billion in cash this year. Ford's B+ junk credit rating is already on credit watch with negative implications—and Standard & Poor's will decide this month if another downgrade is needed.

Yes, Mulally has enough cash to keep Ford afloat for some time. But not indefinitely. That's one reason why management is shopping its luxury brands. Even the idea of selling 51% of its profitable Ford Motor Credit Co. finance business has been floated.

Why does Ford need the cash? If the next round of restructuring stems the losses, its revenues are expected to keep falling anyway. They're down \$7 billion, to \$83 billion, in the first half of the year. If that isn't stabilized, Oline says, Ford will have a tough time slowing the cash burn. And even though its pension fund in the U.S. is underfunded by only \$2 billion, the company still lives

## BIO

# Alan R. Mulally

**BORN** Aug. 4, 1945, Oakland, Calif.

**EDUCATION** BS, 1967, and MS, 1969, aeronautical and astronautical engineering, University of Kansas; MA, Sloan School of Management, Massachusetts Institute of Technology, 1982.

**FORMER JOB** President and CEO, Boeing Commercial Airplanes.

**NEW JOB** President and CEO of Ford Motor.

**PROMINENT OFFICE ART** A 5-by-3-foot photo of Mulally and his five children posing next to a gorilla statue at the San Diego Zoo.



**HOBBIES** Tennis—he played on the semi-pro circuit—and golf; flies small planes.

**IN HIS GARAGE** Lexus LS 430 sedan.

**FAMILY** Married to Jane "Nicki" Connell; three sons and two daughters.



with the risk that a downturn in equity markets could force it to pony up more cash. Since 2004, Ford has paid \$5.3 billion in cash into its pension funds.

## MARKETING NIGHTMARE

MULALLY HAS EARNED high marks in the aerospace industry for his stewardship of two of Boeing's most successful projects, the 777 jet and, more recently, the game-changing lightweight 787. But developing smart products at an auto company, especially with huge holes in its model lineup, is an entirely different proposition. In an interview with *BusinessWeek*, an upbeat Bill Ford insisted that Mulally would get plenty of support. "Alan will have all the help he needs from inspired car guys," said Ford. "What our inspired car guys need is inspired direction."

Mulally demonstrated gold-plated leadership managing the 777 and 787 projects. The 777 was a gutsy attack on conventional wisdom. Plenty of safety experts believed twin-engine planes couldn't safely fly over the vastness of the Pacific Ocean. But Mulally pushed ahead—developing a plan,

getting his troops to buy in, then focusing relentlessly on executing his vision. He has brought the same zeal to the 787 project.

Impressive feats, but quite unlike the product and marketing challenges Mulally has inherited at Ford. Boeing's commercial aircraft division is essentially a B-to-B manufacturer; it builds planes for airlines and cargo haulers. For the most part, Ford is a consumer brand, and a badly degraded one at that. To excite buyers, it needs somebody who understands car color and fashion trends, things that don't matter much to aircraft manufacturers.

Ford's dire financial situation notwithstanding, what has investors and analysts most concerned is the automaker's serial inability to come up with hit products. Sales of the company's bread-and-butter SUVs and trucks are sliding amid high gasoline prices, but Ford can't seem to build passenger cars that people want. Merrill Lynch & Co. analyst John Murphy says that for the next three years only 60% of Ford's models will be replaced. That compares poorly with 80% at GM and 83% at Toyota. The upshot, accord-

ing to Murphy: Ford will lose about one percentage point of market share a year until 2010. There's not much Mulally can do about that since it takes about five years for Ford to get a vehicle from drawing board to showroom.

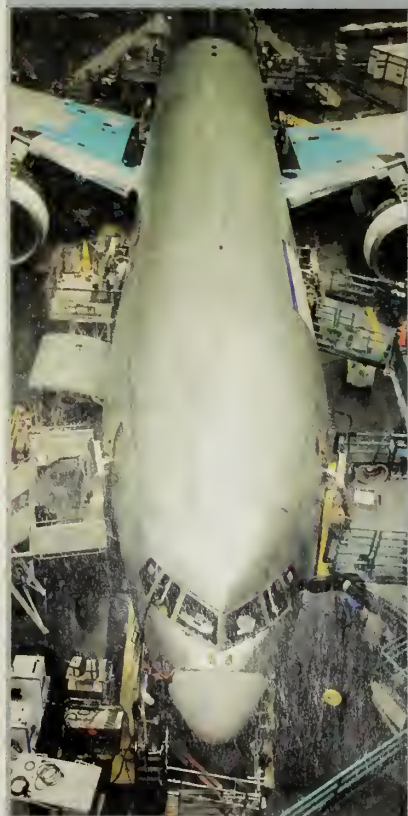
"Going to market" is a phrase auto executives understand all too well, but may take a while to fully resonate with the Boeing transplant. And Ford is a marketing nightmare. Not only has the message bounced all over the place, but the company must overcome a prevailing sentiment among consumers that the quality of its products just can't stack up against the Japanese. The fact that Ford's quality has improved in recent years simply hasn't registered with the driving public. The stick-to-it Mulally may be able to impose some consistency on the marketing message, but restoring luster to a faded brand will take a marketing genius. ■

—With Jena McGregor in New York

**BusinessWeek online** For a Q&A with Ford Chairman Bill Ford and new CEO Alan Mulally go to [www.businessweek.com/extras](http://www.businessweek.com/extras)

## A Different Scale of Difficulty

Mulally restructured Boeing's commercial plane division. But Ford is much bigger, and so are its problems



| BOEING<br>COMMERCIAL<br>AIRPLANES                              | FORD<br>MOTOR<br>COMPANY                                     |
|----------------------------------------------------------------|--------------------------------------------------------------|
| MODELS<br>18                                                   | MODELS*<br>52                                                |
| EMPLOYEES<br>53,391                                            | EMPLOYEES<br>300,000                                         |
| 2005 REVENUES<br>\$22.7<br>BILLION                             | 2005 REVENUES<br>\$170<br>BILLION                            |
| 2005 OPERATING<br>PROFIT<br>\$1.4<br>BILLION                   | 2005 OPERATING<br>PROFIT<br>\$2.2<br>BILLION                 |
| 2005 OPERATING<br>MARGIN<br>6.3%                               | 2005 OPERATING<br>MARGIN<br>1.25%                            |
| PLANTS<br>6<br>BUT CONTRACTS WITH A<br>WORLDWIDE SUPPLIER BASE | PLANTS<br>110<br>WORLDWIDE INCLUDING<br>JOINT-VENTURE PLANTS |
| BRANDS<br>1                                                    | BRANDS<br>8<br>INCLUDING CONTROLLING<br>INTEREST IN MAZDA    |

Data: Company reports



\*U.S. models only. Worldwide, the company has 2,385 products, including model variants.



## INVESTIGATIONS

# WHAT WOULD HEWLETT AND PACKARD SAY?

An ugly spat over boardroom leaks casts a pall over HP's remarkable comeback

BY PETER BURROWS

**I**N FEBRUARY, 2005, WHEN Patricia C. Dunn replaced Carleton S. "Carly" Fiorina as chairman of Hewlett-Packard Co., she inherited a deeply flawed board. That was the conclusion of the board itself, through an audit it commissioned in the tumultuous days leading up to Fiorina's ouster. The audit revealed such problems as a lack of heavyweight outside executives and lousy communication.

Dunn, a former CEO of Barclays Global Investors, set to work fixing things. The board recruited new directors, such as McKesson CEO John H. Hammergren. She hired a governance expert to help directors brush up on the latest regulations. Dunn also moved on another problem noted by the audit: Too many of the board's secret deliberations had been leaked to the business press. And oh, what a mess that last one has created.

On Sept. 6 the company admitted that in trying to identify the source of the leaks, an investigator improperly gained access to the phone records of former director Thomas J. Perkins. He has notified several government agencies of possible wrongdoing by the board. The ensuing turmoil seems unlikely to derail the impressive turnaround engineered by Mark V. Hurd, Fiorina's CEO successor. But the legal implications are still murky, and lawyers say HP faces some risk of civil or even criminal charges. California Attorney General Bill Lockyer told Reuters that he had issued subpoenas to various parties.

The incident may leave an indelible stain on a company known for decades as Silicon Valley's exemplar of corporate virtue. Throughout the Valley, HP veterans were shocked that this Nixonian plot could have taken place at the company founded by icons Bill Hewlett and Dave

Packard. Screamed the mocking headline of a blogger at SiliconValley.com: "Our boardroom lighting system is powered solely by Hewlett and Packard spinning in their graves."

Leaks themselves are hardly a rarity in boardrooms. In fact, insiders say productive talks between the board and Fiorina ended when details of a key meeting showed up in *BusinessWeek* and *The Wall Street Journal*. "Leaks are a part of life," says Charles M. Elson, director of the John L. Weinberg Center for Corporate Governance at the University of Delaware. In the rare cases where leaks become an issue for boards, he says, the question is whether the leaker violated a fiduciary duty or believed that getting information out was in the best interest of the company. Given the 69% rise in HP's shares since Fiorina's ouster, its leaks may have harmed Fiorina, but it's hard to argue they hurt the company.

Nevertheless, HP set out to squelch all leaks in no uncertain terms. After he

### HOT SEAT

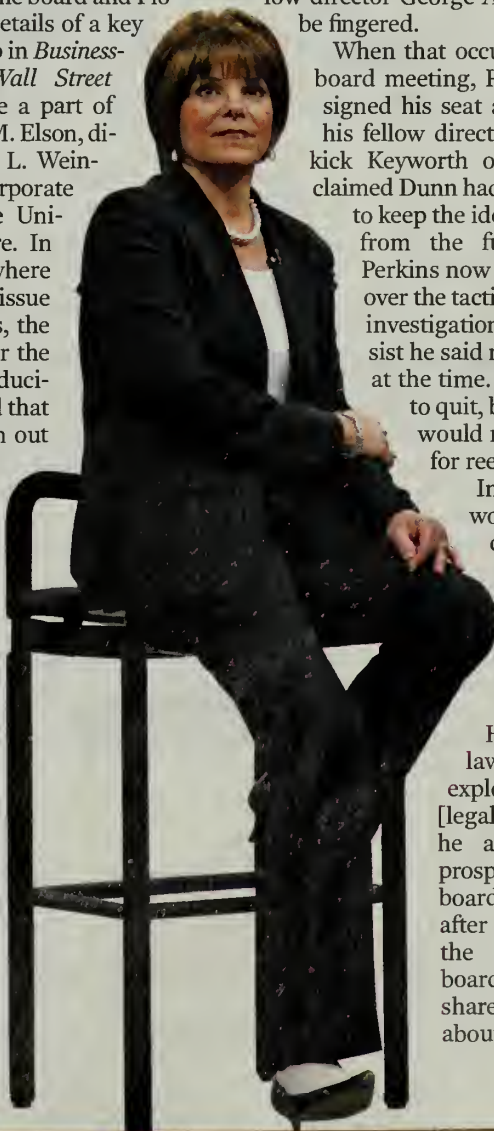
Dunn inherited a deeply flawed board

was hired in March, 2005, Hurd made a point of saying at employee meetings that he would personally fire anyone who had unauthorized discussions with reporters. Around that time, Dunn gave HP's internal investigations unit clearance to hire gumshoes to find the boardroom leaker. Three directors say the probe was common knowledge on the board and that Dunn gave a status report at every meeting, though she didn't talk about tactics. Leaks seemed to subside, but the investigation jumped to the fore after a CNET.com story in January cited details of board discussions, including plans to use more chips from Intel Corp. rival Advanced Micro Devices Inc.

Until that time, three HP directors say, Perkins had been one of the most hawkish about shutting down leaks. He suspected a top HP executive, and suggested Dunn employ lie detector tests—a charge Perkins' lawyer, Viet Dinh, denies. But HP directors say his attitude changed when, they believe, he sensed his friend and fellow director George A. Keyworth might be fingered.

When that occurred at a May 18 board meeting, Perkins angrily resigned his seat as it became clear his fellow directors were going to kick Keyworth off the board. He claimed Dunn had broken a promise to keep the identity of the leaker from the full board. While Perkins now insists his gripe is over the tactics used during the investigation, HP directors insist he said nothing about that at the time. Keyworth refused to quit, but was advised he would not be on the slate for reelection in 2007.

In an e-mail, Keyworth declines to comment other than to say: "I am dedicated to HP's continuing progress under the leadership of Mark Hurd." Perkins' lawyer says "we're exploring all available [legal] remedies." But he agrees Hurd has prospered "despite" the board's disarray. That, after all, may well be the only thing the board's employers—HP shareholders—care about in the end. ■







TUNED IN MTVN got wide media play from its annual Music Video Awards

## EXECUTIVE SUITE

# VIACOM: A SURPRISE FALL REPLACEMENT

Redstone's ouster of a popular CEO could further divide the "creatives" and "suits"

BY TOM LOWRY  
AND RONALD GROVER

**D**URING A RETREAT LAST January in Miami's South Beach, members of the ad sales team of MTV Networks were pumped about a new era for corporate parent Viacom Inc., freshly split from CBS. As they munched on chicken wings and sipped gin and tonics poolside, longtime staffers joked that the new name for Viacom should be "TomCo," a reference to the popular Tom Freston. A founder of MTV, he was picked 25 years later by Viacom's chairman and controlling shareholder, Sumner M. Redstone, to be chief executive officer of the cleaved Viacom. The 60-year-old Freston would now bring his MTV chops to the bigger entertainment company.

Less than nine months later, TomCo is TomGo. Freston is out, pushed aside by Redstone, who had lost patience with Viacom's

stumbling stock price. The Sept. 5 announcement that Freston had resigned under pressure left many shocked that the new CEO had not been given more time to prove himself. Redstone, who controls 72% of the voting shares, had tired of other executives in the past and shown them the door, including Frank J. Biondi Jr. and Mel Karmazin. But neither had been as much a part of the fabric of the company as Freston. Rank-and-file workers at Viacom's Times Square headquarters, coming off the high of Aug. 31's widely distributed MTV Music Video Awards, were stunned when they returned after Labor Day to discover Freston was out, say insiders, leaving some in tears.

Those emotions may portend more tumult and perhaps more high-level departures at Viacom, particularly at MTV Networks, which accounts for about 85% of the parent's operating



FRESTON

profits. At a company historically divided between the "creatives" and the "suits" Freston was always a willing buffer between those camps. Booting him could very well spark a cultural crisis for Redstone and Freston's successor, the octogenarian's longtime associate Philippe Dauman. Management of top talent could even get messy. (MTV's *Comedy Central* star Jon Stewart is a good friend of Freston's.) As a Viacom director and former vice-chairman, Dauman, 52, had worked with many of the senior staffers there before and largely received good reviews. Still, some insiders are concerned that in this new role and under Redstone's constant scrutiny, relationships could be tested.

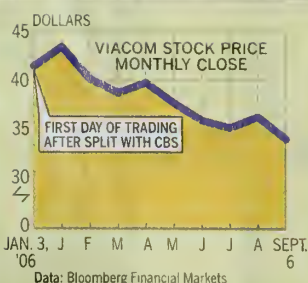
The change in leadership, for one, put enormous new pressure on MTVN CEO Judy McGrath, who could be exposed even more to the full brunt of Redstone's ire over the stock price. Hired 25 years ago, McGrath was one of Freston's closest allies at Viacom. If McGrath were to quit, speculation is that another MTV veteran, Van Toffler, would be in line to get the top spot. Toffler, a lawyer, had good relationships with such major business partners as Microsoft Corp. The regime change also raises questions about the future of MTVN Chief Operating Officer Michael Wolf, a high-profile

media consultant recruited as a rare outsider to the company in November. Even before the bomb dropped on Freston, Wolf, who had no operating experience before he arrived, got off to a rocky start after knocking heads with staffers, say Viacom executives. An MTVN spokeswoman declined to comment.

Redstone downplayed the impact of Freston's departure in an interview on Sept. 5. He says he quickly placed phone calls to several of Freston's top lieutenants, including McGrath and Paramount studio chief Brad Grey, both told him they intended to stay on the job. Even if either is thinking of leaving now, Redstone says, "they have contracts with us. Both said that they wanted to continue to build on what they had started."

Any regrets about splitting his company in two? No way, insists Redstone. But it could be that a creative entrepreneur like MTVN, now a more central piece of Viacom, needs a little insulation against the demands of the larger company. The Dauman era, executives still need to persuade Wall Street that Redstone made the right choice in January—also in September. ■

## WHERE'S THE BUZZ?



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# Plenty of Oil—Just Drill Deeper

The discovery of reserves in the Gulf of Mexico means supply isn't topping out

COMMENTARY BY MARK MORRISON

**Y**OU CAN TUNE OUT ALL THE scare talk about Peak Oil for a while—probably a long while. Peak Oil is the theory, on the verge of becoming conventional wisdom, that the world's petroleum supply is topping out and will not be able to meet global demand soaring along with the economies of China and India. But a successful test in a mammoth field deep beneath the Gulf of Mexico, announced on Sept. 5 by Chevron, Devon Energy, and Norway's Statoil, should help put that scary scenario on hold for decades.

One huge oil reserve, even if it could rival the 1968 discovery of Prudhoe Bay and increase U.S. reserves by up to 50%, will not turn around the world's tight energy markets, of course. It won't even bring the U.S. close to energy independence when oil and gas get into full-fledged production four or five years from now.

But the capability to find and recover petroleum at extreme depths, temperatures, and pressures, as demonstrated by the Chevron team, may indeed tip the balance of supply and demand in the long term. There will be a new frenzy of drilling at these depths in the Gulf of Mexico, where about a dozen promising exploration wells have already been drilled.

Other parts of the world that once appeared beyond the pale may also come into play. Areas believed to have oil deposits extremely deep beneath the ocean floor, which could now become commercially recoverable, include the North Sea off the coast of Britain, the Nile River Delta off the coast of Egypt, and possibly coastal Brazil, says Andrew Latham, a vice-president at energy consultancy Wood Mackenzie in Edinburgh, Scotland. Other analysts say West Africa could harbor lots of ultra-deep deposits. The areas have produced oil before but never from these depths.

The record-setting Chevron well, called Jack 2, which is 5 miles off the Louisiana coast, is more than five miles deep, including more than a mile of ocean depth. Modern 3-D seismic gear enabled the team to know where to drill to have a chance to make their \$100 million-plus bet that oil would flow from such a deep formation. The drilling was the work of an advanced deep-sea rig—Transocean Inc.'s Cajun Express—one of 13 the company has launched since 1998 capable of drilling depths of 35,000 feet, about double what the previous generation could do. Earlier drilling had established promising reserves in an area of the Gulf 300 miles long and 80 miles wide, but the Chevron project found a flow rate of more than 6,000 bbl. a day of light, sweet crude. The discovery confirmed the area's commercial viability, strengthening hopes that as many as 15 billion barrels of oil could be recovered in the vicinity.

Pioneering isn't cheap. Steel and skilled labor rates are rising through the roof, as are rental rates for state-of-the-art offshore rigs. BP, for example, will be paying \$520,000 per day starting late next year for the same rig it is now getting for \$190,000 per day. That's because these fancy rigs, which

house 200 people and rise 415 feet into the air, are in short supply with drilling picking up. Still, energy experts believe that producing oil from ultra-deep wells can be profitable as long as oil is selling for \$67 per barrel today, stays at or above \$40 to \$45.

Matthew R. Simmons, chairman of an energy investment bank bearing his name and one of the leading proponents of Peak Oil, is sticking to his guns. "One well tells you almost nothing," he says. Simmons says the deep wells are "unbelievably expensive" and often fall short of expectations. "The history of the industry is full of disappointment."

But given the powerful combination of high oil prices and new technology, the industry is gaining confidence that supplies will grow. It's pushing hard to produce oil and gas from difficult tar sand and shale fields as well as rejuvenating older fields with enhanced recovery methods. Cambridge Energy Research Associates predicts world oil and natural gas liquids capacity could increase as much as 25% by 2015. Says Robert W. Esser, a director of CERA: "Peak Oil theory is garbage as far as we're concerned."

—With Stanley Reed in London and Chris Palmeri in Los Angeles

## THE STAT

# 25%

Estimated rise in global oil and natural gas liquids capacity by 2015

Data: Cambridge Energy Research Associates



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## DEALS

# HOW SARA LEE LEFT HANES IN ITS SKIVVIES

The newly spun-off maker of underwear and clothing could now be hobbled by debt

BY JANE SASSEEN

**D**ID SARA LEE steal a page from the private equity playbook with its successful spin-off on Sept. 5 of Hanesbrands Inc.? It sure looks that way. As part of the deal, Sara Lee Corp. loaded up the apparel maker with billions in new debt, then paid itself a big, fat dividend—money it'll use to trim its own debt and buy back shares. Hanes, by contrast, will start life as a public company with a bond rating in junk status and a debt load so onerous some worry it won't be able to invest enough in its well-known clothing brands.

It's the sort of financial engineering that has more in common with the world of leveraged buyouts than with corporate spin-offs. And at first blush, from Sara Lee's perspective, the deal makes sense. Why should executives rely solely on the fickle stock market to recognize the worth of Hanes as a stand-alone company when they can grab some cold cash now and put it to work immediately?

But if Hanes can't sustain the debt over the long term, investors holding shares of both companies might be worse off for the maneuver. Analysts say the amount of debt—as well as the dividend Sara Lee paid itself—was considerably more than expected. To capitalize the spin-off, Hanes took on new debt totaling \$2.6 billion. Most of those proceeds went to Sara Lee in the form of a \$2.4 billion dividend.

Overburdening Hanes with debt leaves it in a weaker financial position

than many of its rivals. Standard & Poor's has given the new company a B+ credit rating, which puts it in the bottom half of the apparel sector. The level of Hanes's debt compared with earnings before interest, taxes, depreciation, and amortization (EBITDA) is 4.52, the highest in its peer group, says Joseph W. Cornell of Spin-Off Advisors, a specialized research and investment firm. The ratio of its earnings to interest charges, at 2.65, is also weak.

Sara Lee executives declined to comment for this story. A Sara Lee spokesman says the company believes

Hanes's level of debt is appropriate. Hanes spokesman says the company generates enough free cash to fund investment as well.

The Sara Lee move didn't occur in a vacuum. It's part of a broad restructuring that CEO Brenda C. Barnes announced back in 2005. Her goal then: to spin off and sell some 40% of the company for around \$3 billion and concentrate on well-known food brands. So far she has fallen short: Sales of units have brought in just \$1.4 billion. Hence the need to get more cash out of Hanes.

Certainly, it's not unusual for a parent company to pull money from a unit it is spinning off. But the payment of so large a dividend out of a freshly minted debt has raised eyebrows among analysts. For spin-offs enter the market highly leveraged: Of the companies spun off since the beginning of 2005 that have debt rated by Standard & Poor's, only three are rated lower than Hanes.

## LOWER RETURNS?

TIMOTHY S. RAMEY, a former Sara Lee executive now at bankruptcy D.A. Davidson & Co., says the deal makes little sense from the perspective of shareholders of both companies. "They are raising high-cost junk debt to pay off low-cost investment-grade debt, and that will leave shareholders poorer overall." Like many companies

that have gone through LBOs, Hanes will spend the next few years using its cash flow to pay down debt. For investors, that may dampen returns at least for a while. Spin-Off Advisors' Cornell says Hanes's heavy leverage will keep it from outperforming the market in many spin-offs.

Don't expect that to discourage more spin-offs, though. As long as there are buyers willing to snap up high-yield

debt like the stuff Hanes floated—even when the benefits don't go to the company footing the bill—more sellers will emerge. Says Tom Marshall, a managing director of leveraged finance at credit ratings agency Moody's Investors Service, "Companies do this because they can



## Stretched

Hanesbrands carries a much heavier debt load than rivals since it parted company with Sara Lee

|             | TOTAL DEBT TO EBITDA* RATIO |
|-------------|-----------------------------|
| VF Corp     | 1.00                        |
| Maidenform  | 2.84                        |
| Warnaco     | 3.09                        |
| Hanesbrands | 4.52                        |

\*Earnings before interest, taxes, depreciation, and amortization. Data: Bloomberg Financial Markets, Spin-Off Advisors

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## OUTSOURCING

# LET'S OFFSHORE THE LAWYERS

## DuPont is farming out legal services to Asia—and saving a bundle

BY PETE ENGARDIO

**M**ENTION OFFSHORE outsourcing, and Americans fume. But who would cry if we outsourced the work of lawyers, with their fat fees and endless strategies for adding years to litigation? Sounds like a great idea, but many might say it can't be done anyway. Legal work is too sensitive and technical to risk farming out to Asia.

Try telling that to DuPont, the giant chemical company. On the seventh floor of an old office building on the outskirts of Manila, 30 Filipino attorneys, including three who have passed U.S. bar exams, are seated elbow-to-elbow with 50 other staff at long tables crammed with PCs. Working in three shifts seven days a week, they read, analyze, and annotate digital images of memos, payroll and medical records, old engineering specs, and other documents that might be used as evidence in DuPont legal cases.

The operation is part of a tieup between DuPont and offshoring shop OfficeTiger that is testing the limits of how far legal services outsourcing can go. Attorneys and others in OfficeTiger's Philippines and India offices are helping out on more than a dozen projects, from monitoring old contracts and licensing agreements to managing documentary evidence for product-liability cases. "We want to be the center of excellence for this whole area of offshore document management," says DuPont assistant general counsel Thomas L. Sager.

The most important project is processing 2 million pages of documents vital to a

DuPont case against 10 insurers. DuPont aims to recover more than \$100 million in payouts to thousands of former pipefitters, insulators, mechanics, and other workers who claimed their illnesses came from exposure to asbestos in DuPont facilities. Much of the work is tedious: digitizing and indexing decades-old paperwork. But some requires judgment normally provided by U.S. lawyers, such as determining whether documents are relevant to a case or violate confidentiality.

### COST-CUTTING PIONEERS

BY GOING OFFSHORE, DuPont aims to save 40% to 60% on document work and cut up to \$6 million from its annual \$200 million-plus in legal spending. It also hopes to shave months off the discovery process in court cases. But the move is risky. In industries from software to customer support, corporations have run into myriad logistical and quality prob-

lems with offshore outsourcing. If OfficeTiger stumbles and doesn't have evidence ready by December, when asbestos case could go to trial, it could cost DuPont millions.

But if OfficeTiger delivers, it could mean big changes for the \$225 billion U.S. legal services industry. DuPont's legal department has been a pioneer in cost-cutting since the early 1990s, saving more than \$100 million at that time through automation, outsourcing, and reducing the number of outside law firm uses. Offshoring is the logical next step. Within firms in India, the Philippines, and elsewhere have been processing legal documents for years on a small scale, the size and complexity of DuPont deal with OfficeTiger.

## DuPont's New Brief

By hiring OfficeTiger to manage millions of documents, DuPont is pushing legal services outsourcing to a new level.

**COST REDUCTION** Handling documents in Asia can cut expenses by more than half. That could ease pressure on DuPont to settle cases rather than fight.

**SPEED** Collecting and processing evidence can take 18 months in a big insurance case. With global teams working 24/7, DuPont hopes to cut that to three months.

**STREAMLINING** OfficeTiger will convert millions of old records now stashed in warehouses into digital form, then code and index them, making it easier to analyze evidence.

Data: DuPont







shes it to a higher level. "If DuPont es well with this, you will find other mpanies taking a good look," says adford W. Hildebrandt, chairman of the gal consulting firm Hildebrandt Inter- tional Inc., which estimates U.S. firms n save 25% to 35% by farming legal rk to Asia. "Ultimately, there may be le limit to what can go offshore." That doesn't mean U.S. lawyers will be tting pink slips, or even lowering their ourly fees. They're still needed for devel- ing arguments, writing briefs, and her trial work. But DuPont figures 70% the labor in a typical insurance or lia- lity case can be outsourced. U.S. law ms often bill around \$150 an hour for ocument-processing by paralegals. aw firms historically have made much their revenue on administrative and ralegal work you don't really need a wyer to do," says OfficeTiger Co-CEO seph Sigelman. Offshore providers ch as OfficeTiger, bought in April by R. Donnelley & Sons Co., charge ound \$30 an hour. That's possible be-

cause an attorney with five years of experience can be hired for around \$30,000, including benefits, in the Philippines, whose legal system is similar to America's. That's half what a veteran U.S. corporate paralegal earns, and one-fifth what a first-year attorney can fetch in New York.

Few industries seem more ripe for radical restructuring than legal services. For starters, they remain remarkably mired in paper. At its Wilmington (Del.) warehouse alone, DuPont has more than 200,000 boxes, each typically stuffed with 2,500 pieces of paper. Analyzing those documents involves photocopying the pages and shipping them to lawyers, who then pore over them.

Now, OfficeTiger staffers take portable scanners to sites where documents are stashed and zap images of scanned pages to a secure database. In minutes, Filipino

## If DuPont's offshore team fumbles, big savings won't matter

attorneys can retrieve the material on their PCs. One of them is Eric Himan, a thirtysomething former corporate lawyer and Manila law school grad. "I want to work on really big, meaningful cases so that my market value can go up, rather than litigate some minor local dispute," Himan says as he reads through old e-mails relating to an asbestos case. He enjoys conference calls with top U.S. lawyers, who often ask his opinion on evidence and strategy. "Our input is valued," he says. "Not many lawyers in the Philippines get to do what we do."

### VAST TIME SAVINGS

BY THE TIME the documents get back to Wilmington, they are attached to electronic files about each asbestos litigant, along with data on how damages paid by DuPont were calculated. DuPont lawyers then review the work. By delivering neatly organized and reliable digital evidence to opposing attorneys, DuPont hopes it can slash the discovery process in insurance cases to three months from an average of 18 months. So far, the work has been accurate and on schedule, says DuPont's Sager. He says the move might also send the mes-

sage that DuPont can afford to fight cases more aggressively, rather than settle due to the expense. "Corporations are looking for alternative ways to buy legal services so that cost does not become an issue in deciding whether or not to defend a case," says Sager.

For OfficeTiger, success could mean a surge in business. By the end of 2007, Sigelman predicts his Asian legal team could reach

1,000 with several hundred lawyers. He also believes U.S. clients will become more willing to hand over sensitive work such as research for briefs. Is the U.S. legal industry ready for such a leap? "The proof will be in the pudding," says DuPont counsel Silvio J. DeCarli, who manages the asbestos litigation. "If this case implodes because of what OfficeTiger did or did not do, whether we save money won't be important." ■

—With Assif Shameen in Manila



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HIGH HOPES

# RUSSIA'S GRAND PLAN TO RESTORE ITS GLORY

An aerospace shakeup is part of Putin's campaign to create global giants

BY JASON BUSH

IS IT AN OPPORTUNISTIC PIECE of financial speculation, or the start of a new strategic partnership? That's the question following recent reports that Russia's Vneshtorgbank (VTB) has laid out \$1 billion for nearly 5% of the European Aeronautic Defence & Space Co. (EADS), which owns Airbus. Neither VTB nor EADS would comment.

VTB's interest might be explained by the price of EADS shares, which have fallen 28% this year, largely over concerns about Airbus' new A380 megajet. But state-owned VTB works closely with the Kremlin, and Russia's own aviation industry is about to launch a major restructuring. Under a Kremlin-approved plan, eight aircraft plants and five design bureaus are to be merged into a giant holding called United Aircraft Corp. The company, which will be 75% state-owned and boast close to \$3 billion in revenues, could benefit from links to Western aerospace outfits. Indeed, EADS will own about 2.5% of United Aircraft through its 2004 purchase of 10% of Irkut Corp., a unit of the holding company.

The shakeup is just the latest example



OUT OF DATE  
Planemakers  
need Western  
knowhow

of a major shift under way in Russia. In a bid to reestablish the country's industrial might, President Vladimir V. Putin is overseeing the creation of large corporations, owned or heavily backed by the state, that will dominate strategic sectors and act as national champions abroad (table). It is in aerospace that Russia's yearning to regain lost prestige is most evident. During the Cold War, Russia was second only to the U.S. in aviation. While Russia still accounts for some 25% of the global market for military aircraft,

it makes just a dozen or so passenger jets annually, or less than 1% of the world market. Its planes are still based on Soviet-era models that pollute, gulp fuel, and have a poor safety record.

## TECHNOLOGY HUNGER

OVER THE COMING decade the government has promised to invest \$13.7 billion in United Aircraft. Moscow also seems keen to attract foreign partners that have the technology needed to drag Russian aircraft designs into the 21st century. The industry is pinning its hopes on niche models such as the Sukhoi Superjet 100, a new 95-seat passenger plane that has the backing of Boeing, French engine maker Snecma, and Italy's Finmeccanica.

"Russia's aviation industry will be saved by cooperation with European and American companies," says Victor Soubbotine, general director of Sukhoi Civil Aircraft Co., which will become part of United.

Such cooperation could include a strategic tie-up with a company such as EADS. Russia

is "a potential source of lower-cost components for Airbus, which needs to address its lack of competitiveness," says Nick Cunningham, an analyst at London brokerage Panmure Gordon.

Although EADS may not want to create a strong link with Russia, which could hurt its chances of winning U.S. defense contracts, Moscow's hopes are still likely riding on injections of Western technology. It's probably the only way Russia's aviation industry can get back in the global game. ■

## National Champs

Russia's investment in EADS may give a boost to United Aircraft, one of the industrial behemoths taking shape under Putin

**GAZPROM** Now firmly under Kremlin control, Russia's largest company is an important foreign policy tool and a key player in global energy. **Revenues:\*** \$49 billion

**ROSNEFT** The once-tiny state-owned outfit has emerged as a major oil player after swallowing up assets from Yukos with strong backing from the Kremlin. **Revenues:\*** \$24 billion

**RUSAL** The private company could become the world's biggest aluminum producer if its Kremlin-backed merger with Russian rival Sual goes through. **Revenues:\*\*** \$9 billion

**AVTOVAZ** The No. 1 carmaker is under state control after officials from Russia's arms export agency took over. Now, it might merge with two other automakers. **Revenues:\*** \$5 billion

**UNITED AIRCRAFT** To resuscitate the struggling aviation sector, Moscow is merging Russia's aircraft producers into a single entity to be 75% owned by the state. **Revenues:\*\*** \$3 billion

**VNESHTORGBANK** Russia's No. 2 finance player, state-owned Vneshtorgbank, is also among the country's fastest-growing with its acquisitions of private banks. **Assets:\*** \$37 billion

\*2005 \*\*est. post-merger  
Data: Russian Industry & Energy Ministry, BusinessWeek



# Special Report





# Helping Big Brother Go High Tech

**Cisco, Oracle, and other U.S. companies are supplying China's police with software and gear that can be used to keep tabs on criminals and dissidents. By Bruce Einhorn and Ben Elgin**

**G**OOGLE, YAHOO!, AND Microsoft endured a wave of public disapproval earlier this year over their compliance with Chinese censorship of their Web sites. But another striking form of tech commerce with China is taking place below the radar of the U.S. public: Major American manufacturers are rushing to supply China's police with the latest information technology.

Oracle Corp. has sold software to the Chinese Ministry of Public Security, which oversees both criminal and ideological investigations. The ministry uses the software to manage digital identity cards that are replacing the paper ID that Chinese citizens must carry. Meanwhile, regional Chinese police departments are modernizing their computer networks with routers and switches purchased from Cisco Systems Inc. And Motorola Inc. has sold the Chinese authorities handheld devices that will allow street cops to tap into the sorts of sophisticated data repositories that EMC Corp. markets to the Ministry of Public Security.

"It's a booming market," says Simon Zhou, the top executive in Beijing for EMC, which is based in Hopkinton, Mass. "We can expect big revenue from public security" agencies in China.

The scramble to sell technology to Chinese law enforcers seems, for starters, to be at odds with the intent of an American

export law enacted after the massacre of hundreds of pro-democracy demonstrators in Tiananmen Square in 1989. The Tiananmen sanctions prohibited the export "of any crime control or detection instruments or equipment" to China. "We wanted to undermine the effectiveness of the police in rounding up, imprisoning, and torturing political dissidents, not only those involved in the Tiananmen Square movement, but for years to come," explains Representative Tom Lantos (D-Calif.), who helped draft the law.

## No Handcuffs

BUT THAT MESSAGE has been muffled. The Commerce Dept., which enforces the sanctions, has applied them primarily to such low-tech items as handcuffs, helmets, and shotguns. Little of the modern information technology now sold to Chinese police appears on the banned list. Reliable revenue figures for the IT sales aren't available, but industry analysts estimate they total tens of millions of dollars a year and are growing.

American manufacturers say they have no obligation or ability to determine whether Chinese security forces use the technology for political repression. On the contrary, American capitalism improves the lot of ordinary Chinese, some executives contend. "Anything that helps China to modernize will help China to improve its human rights situation," says John S. Chen, chief executive of Sybase Inc., a

Dublin (Calif.) company that sells database programs to the Shanghai police. "The more accurate information the police have about an individual target, the more accurate and sensible they can be."

But the same technology that helps track down drug dealers or murderers can also be deployed to trace and arrest dissidents, says Eric Harwit, a China scholar at the University of Hawaii. "It's a double-edged sword."

Despite the improvement of its image on the world stage, China still has a dismal human rights record. The U.S. State Dept. says that the Communist government is holding at least 260,000 people in ideological "reeducation" camps. Among those detained are pro-democracy activists and members of the Falun Gong spiritual movement, which the government considers an illegal cult. U.S. technology has been used at least indirectly to improve the government's ability to identify Falun Gong adherents, according to Hao Fengjun, a former security official who has fled China for Australia.

Some American companies have gone out of their way to appeal to the Chinese government's pronounced concern about avoiding unrest. In Chinese-language brochures distributed at a police-technology trade show in Shanghai in 2002,





A Chongqing police officer surveys the streets electronically.

## “WE DO BUSINESS [in China] the way we do business anywhere,” says Cisco's SVP for worldwide operations

Cisco repeatedly referred to its gear with such phrases as “strengthening police control” and “increasing social stability.” Cisco, based in San Jose, Calif., says there’s nothing unusual about its marketing in China. “We sell to police organizations in many countries,” says Rick Justice, senior vice-president for worldwide operations. “We do business [in China] the way we do business anywhere.”

Cisco and other companies emphasize that, as required by law, they obtain licenses from the Commerce Dept. for tech sales to China. “We follow very closely and ethically all the laws the U.S. government has in place,” says Cisco’s Justice. But Richard C. Bush, a former congressional aide who worked on the Tiananmen sanctions, expresses surprise when told of the types of contracts U.S. companies are signing with the Chinese. Bush, a fellow at the Brookings Institution, a Washington think tank, adds: “[Are the contracts] antithetical to what core members of the legislative effort wanted? Yes.”

Some outside analysts attribute Com-

merce’s lenient approach to its enthusiasm in recent years for expanding exports to China. Matthew S. Borman, Assistant Commerce Secretary for export, counters that the agency merely follows the law: “Items controlled under this authority are those exclusively or primarily used for crime control and detection.” Databases or computers that can be used in an ordinary office aren’t covered, he says. But Lantos, the California congressman, says the sanctions have been undermined. “The Commerce Dept.’s decision to interpret the law narrowly is absolutely unconscionable,” he argues. “By allowing American companies to sell high-tech computer and communications devices to the Chinese police, our nation is directly aiding in the suppression of political dissent in China.”

The upshot is that “manufacturers of handcuffs aren’t allowed to sell their products to China’s police, but Cisco and other companies are selling Chinese authorities much more useful technology,” Harry Wu, a former Chinese political prisoner living in the U.S., told a House sub-

committee on human rights in February. His testimony was eclipsed by the panel’s heavily covered excoriation of Google, Yahoo, and Microsoft for their agreement to block parts of their Chinese Web sites as condition of operating in the country.

Thomas Lam, president of Cisco’s Chinese operations, says: “The networking hardware and software products that Cisco sells in China are exactly the same as we sell in every market in the world. It is our users, not Cisco, that determine the applications they deploy.” American companies also argue that if they did not sell to the Chinese authorities, competitors from other countries would provide similar products.

## Golden Shield

UNTIL RECENTLY, most Chinese police operated with rudimentary technology, which, for example, made it difficult for local branches to share information. American companies regard their sales to law enforcement agencies as addressing this need and as part of a broad wooing of Chinese government customers. Oracle, provider of smart-card software to the Ministry of Public Security, does one-third of its business in China with the government, says Del Williams, head of the company’s Asia Pacific Div. Selling to the government

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THIS IS HAPPENING IN CHINA RIGHT NOW

In Hong Kong, a Falun Gong protest of alleged Chinese abuse; Hao (below) in Melbourne



**FOR ALL DISSIDENTS,** [Chinese internal security] offices build a large database. The categories include Falun Gong, the Catholic Church, Protestant churches, and others."

—HAO FENGJUN, FORMER CHINESE SECURITY OFFICER

just part of our regular strategy," he adds. "I don't think any of these projects would be too controversial."

Although some U.S. tech companies have done business with China's police since the 1990s, the true coming-out party for the relationship occurred in December, 2002, at a conference in Shanghai billed as the China Information Infrastructure Expo and sponsored in part by the Ministry of Public Security. Companies from around the globe set up booths to promote their wares, according to documents prepared for the event. The Chinese hosts shopped for digital tools for projects with names such as Golden Customs and Golden Tax.

The campaign to upgrade police technology, which continues today, is called Golden Shield. At the conference, Cisco's booth was surrounded by video screens showing California police officers using Cisco mobile handsets linked to databases of surveillance footage from stores and other public places, according to author Ethan Gutmann, who attended the event and wrote the 2004 book *Losing the New China*. Hopes that Western technology would spark political reform in China have been unfulfilled, he argues.

On Dec. 5, 2002, company representatives took turns delivering 45-minute Golden Shield Solutions seminars. Promotional literature from the conference shows that among those making presentations were Cisco, EMC, Extreme Networks, IBM, Nortel Networks, and Sun Microsystems. This is where Cisco distributed its pledge to support the goal of



"increasing social stability." An IBM handout stated that it would "use its advanced technology to accommodate the country's conditions."

Defending the company's marketing, Cisco spokesman Terry Alberstein says: "The brochures in question were aimed specifically toward local police, outlining how Cisco products can improve access to police IT resources by networking computing devices and extending access to resources, for example making additional information available to police in patrol cars." IBM, Nortel, Sun, and Extreme Networks declined to comment.

Companies use a variety of methods to appeal to Chinese authorities. Motorola and IBM take out ads in a Chinese-language trade publication called *Police Daily*. Motorola strives to serve the Chinese public's desire for capable law enforcement, says Balbir Singh, a senior company executive for Asia.

EMC has fostered key personal rela-

tionships, as when the maker of data storage systems came to the aid of the Ministry of Public Security last September, EMC's Zhou says. The ministry was relocating to new headquarters in Beijing, and its chief information officer, Xie Yipin, realized that his staff was overwhelmed by the task of transferring extensive databases and computer equipment. So Xie called Zhou. Would EMC send over a few engineers, gratis?

A native Chinese who formerly worked for the government and considers Xie a friend, Zhou says he's eager to expand EMC's business with the ministry. "Because we have trust," he adds, "I could send the engineers first, and maybe we would get the money" later.

Just as he expected, EMC has since obtained several contracts with Chinese police agencies, bringing to a dozen the number of security-related projects the company has landed over the past two years, Zhou says. EMC won't discuss the revenue involved. EMC declined to comment.

## Unauthorized Religion

IT'S DIFFICULT to pin down illustrations of Chinese police using American technology to squelch dissent. The Ministry of Public Security would not comment. Company executives stress that they typically don't work directly with security officials to customize hardware or software. Instead, the government employs local Chinese-owned "systems integrators" to do this fine-tuning. "We're just providing a database product," says





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Oracle's Williams. "A database is like a filing cabinet. Somebody has to provide solutions on top of that, and that's done by a Chinese company."

American software can be traced to modernization efforts supporting at least one arm of the Chinese ideological enforcement apparatus: the State Council Leadership Team for Preventing & Handling Cults. More commonly known as the 610 Office, a reference to the date in 1999 on which it was created, this body tracks followers of unauthorized religions, such as Falun Gong. Hao Fengjun worked in the 610 Office in the northern city of Tianjin until he fled China last year. From his new home in Australia, he has added his voice to Falun Gong's protests over being oppressed. Hao says the Tianjin branch has a database containing

## TRADE FLAPS

# Fingerprint Software China Can't Touch

**W**hile lenient interpretation of post-Tiananmen Square export restrictions has allowed some American tech companies to help China modernize its law enforcement, others, such as Cogent Systems Inc., have been blocked from selling to the Chinese police.

Based in Pasadena, Calif., Cogent makes software for storing and comparing fingerprint images. It reported revenue of \$160 million last year from sales around the world of programs used to identify criminals and register voters. CEO Ming Hsieh has long had his eye on the market in China, where he was born and raised. He started Cogent in 1990 after studying engineering at the University of Southern California.

Despite his Chinese ties, Hsieh has been able to do nothing but fume in recent years as the country's public security bureaus have bought fingerprint software from Cogent's international rivals. Such programs are among the few high-tech products explicitly prohibited from U.S. export to China under the post-Tiananmen Square sanctions.

Cogent's prime competitors, Sagem Morpho Inc. of France and Japan's NEC Corp., aren't similarly restricted. Even

some American companies can pursue fingerprint analysis contracts in China, as long as they haven't created the technology. Unisys Corp. acts as a general contractor on some deals involving fingerprint systems, but it is prohibited from using the wares of American manufacturers. "The result is an unfair and uneven playing field," Hsieh complains.

As recently as last year, Cogent officials discussed a potential deal with Shanghai's police department, based on the company's hope of winning an exception from the Commerce Dept. But while company representatives were meeting with officials in Shanghai, Hsieh says, a Chinese competitor, Eastern Golden Finger Technology Co., notified U.S. officials. A Commerce official soon appeared at Cogent's Pasadena headquarters and grilled executives about their Shanghai meetings, Hsieh says. (Commerce declined to discuss the episode, and Eastern Golden Finger didn't respond to requests for comment.)

Despite Cogent's insistence that it hadn't discussed any sensitive technology with the Chinese, Commerce rejected the company's request to pursue the Shanghai deal. In the end, says Hsieh, the business went to Eastern Golden Finger.

—Ben Elgin

## SYBASE sells database programs to police in Shanghai



Sybase's Chen

30,000 practitioners of the banned sect as well as additional names of other unauthorized religious groups. Some of the data were drawn from China's elaborate

*hukou*, the household registration system that helps the government monitor and control the population.

The digitization of *hukou*, an enormous task that is part of the Golden Shield project, has involved American technology, including software provided by EMC, according to EMC executives. "Aside from the public security bureau's use of technology for criminal cases, the most important [use] is the tracking and suppression of Falun Gong followers," says Hao. The American companies emphasize that they don't determine how the Chinese use their products.

While there has been relatively little objection to the tech sales overall, Cisco has encountered more scrutiny than other manufacturers, probably because it has long been active in China. Last year it faced a shareholder resolution demanding more openness about the company's dealings with the Chinese. The resolution was overwhelmingly defeated. ■

—With Peter Burrows in Silicon Valley

## Behind the Times

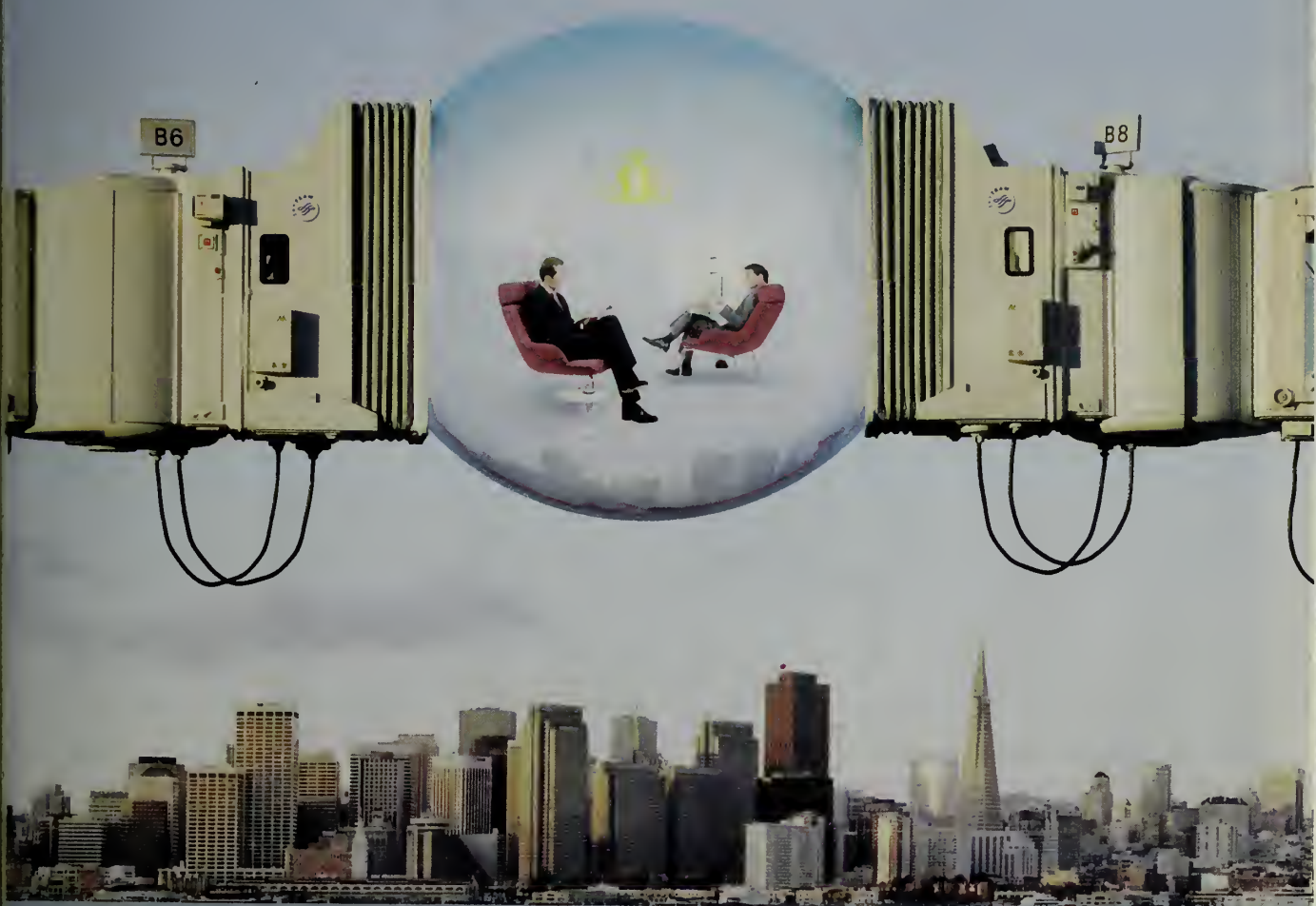
Restrictions enacted in response to the 1989 Tiananmen Square massacre are supposed to block American companies from supplying Chinese security forces, but the Commerce Dept. has applied the law narrowly.

### EXPORTS BANNED

- Handcuffs
- Helmets
- Shields
- Fingerprint powder
- Lie detector machines
- Tear gas

### EXPORTS ALLOWED

- Database software
- Computer routers & switches
- Two-way radios
- Digital ID cards
- DNA analysis gear
- Video probes



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# Global Warming Heats Up Capitol Hill

Lawmakers may finally be crawling closer to a consensus—with business at the table

BY JOHN CAREY

**I**N THE SUMMER OF 2005, SENATOR Jeff Bingaman (D-N.M.) proposed a bill calling for modest mandatory limits on emissions of the greenhouse gases that cause climate change. The utility industry and its Washington-based trade group, the Edison Electric Institute, publicly opposed such curbs. Yet even as the bill failed to win support, some executives at EEI's annual meeting privately voiced a heretical idea. The next President will be more aggressive in taking action against global warming than George W. Bush, one CEO argued, so "this may be the best deal we'll ever get."

Now this heresy is gaining momentum. "The time has come to do something on climate change, and it is better to act sooner rather than later," says Jeffery E. Sterba, CEO of PNM Resources Inc., a New Mexico and Texas utility, who will be chairman of the EEI next June.

Washington is trying. Congress is awash in carbon-capping bills and proposals from Senators John McCain (R-Ariz.), Jim Jeffords (I-Vt.), Tom Carper (D-Del.), John Kerry (D-Mass.), and others. Senator Dianne Feinstein (D-Calif.) plans to introduce legislation on the first day of the next session of Congress, and Bingaman is preparing a more detailed version of his original 2005 bill.

Companion measures are floating in the House. And as Senator Carper makes personal appeals to fellow lawmakers, he's finding increasing support even among Republicans. "They are hearing a growing awareness that global warming is happening, and a growing awareness that people in the utility industry want [regulatory] certainty," he says.

In addition, "energy efficiency, bio-fuels, and climate change are starting to converge in one grand design," says

**Changing Climate**

The energy industry used to balk at bills to curb carbon emissions. Now it is willing to sit down and talk. Here are three senators' proposals:

|                                                                                                                       |                                                                                                             |                                                                                                              |
|-----------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|
|                                                                                                                       |                                                                                                             |                                                                                                              |
| <b>BINGAMAN</b><br>(D-N.M.) Calls for economy-wide curbs, but limits costs to business with a safety-valve provision. | <b>CARPER</b><br>(D-Del.) Positioned as a first step, imposes curbs just on utilities. Has GOP co-sponsors. | <b>MCCAIN</b><br>(R-Ariz.) Extends mandatory emissions curbs economywide, using market-based trading system. |

John Stowell, head of environmental policy at Duke Energy Corp. National security hawks are pushing high-mileage cars and biofuels to reduce oil dependency and the flow of oil-buying dollars to the unstable Middle East, while farm states see revenues in growing crops for fuel.

With California's landmark plan to cut emissions, companies are also increasingly worried about an onerous patchwork of differing state rules. "The California action is a great spur to industry to

push for a coherent national policy," explains Bob Simon, Democratic staff director of the Senate Energy & Natural Resources Committee. Add in the list of Presidential hopefuls who are talking about climate and energy, from Hillary Clinton and John McCain to Mitt Romney and George Pataki, and "a tidal shift is occurring," says Philip Clapp, president of the National Environmental Trust. As Congress begins to look ahead to the post-Bush era, no matter who wins in November, "the legislation that the U.S. will put in place by 2009 or 2010 is taking shape now—and the number of members of Congress abandoning George Bush's position against mandatory cap is just extraordinary," Clapp says.

All of this is eerily similar to the final two years of the Reagan Administration when lawmakers bucked the Gipper's opposition to environmental regulation by shaping what George Bush I would sign as the Clean Air Act of 1990. Now, "if we can get a modest mandatory bill passed in one or two houses, we are laying down the likely bill for whoever is the next President," says Paul Bledsoe, strategy director at the bipartisan National Commission on Energy Policy.

It won't be as easy as it was in 1990 when lawmakers were able to focus solely on pollution from power plants. Now they have to deal with bigger issues. Should greenhouse gas legislation start with utilities only, as in the Carper bill, or rope in the entire economy, as in McCain's? Should the U.S. first fund development of new technologies to help companies meet the rules? And should the U.S. act alone without pushing for limits in China, India, and elsewhere?

Despite the complexity, Washington is beginning to inch toward a possible consensus, with business at the table. "Getting something by 2008 that phases gradually and is able to bring in some of the developing countries could make a lot of sense," says PNM's Sterba. ■



The endless hustle and stress of the modern world - many people accept it as part of the game. But it doesn't need to be that way. When technology helps life run more smoothly, the modern world can be unbelievably peaceful.

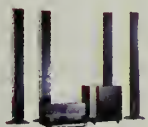
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# YouTube: Waiting For the Payoff

The video-sharing Web site is a runaway success—everywhere but on the bottom line

BY HEATHER GREEN

**Y**OUTUBE INC. IS THE Internet company to beat these days. Wowed by its meteoric rise—the 19-month-old site dishes up 100 million daily videos—startups and giants alike are crowding into the video-sharing market. Microsoft Corp. is developing its own service. And this fall, the founders of the Skype and Kazaa services will unleash the Venice Project, a wannabe YouTube killer built on file-sharing technology.

With all the excitement, it's easy to forget that the video-sharing pioneer's business so far amounts to a whole lot of expenses, not much revenue, and no profits. YouTube took on the job of creating the business model for a new medium where anyone can post any video. While it's starting to develop new ad offerings, its popularity is driving up costs that established Web giants, such as Google Inc. and Yahoo! Inc., are able to spread out. YouTube spends a tidy, and growing, sum to stream its short clips. Current estimates range from \$900,000 to \$1.5 mil-

lion per month. Much of that goes for computer servers and transmission bandwidth. But because the company is charting a delicate course in how it handles pirated videos, its legal costs could balloon if lawsuits start piling up.

Even more important, though, is the tricky question of how YouTube can make money off its phenomenal growth while maintaining the promise behind that popularity. YouTube could easily alienate its users by overwhelming them with ads. And the startup has to figure out how to attract a broader group of marketers by filtering more for copyrighted or offensive videos and by creating more channels of similar content.

Aware of the risks, YouTube co-founders Chad Hurley and Steve Chen are moving slowly to ramp up advertising. They have been wary of asking viewers to sit through a 30-second ad before a two- to three-minute clip. Instead,

## PURE PLAY

Hurley and Chen are wary of saturating YouTube with ads

YouTube is developing new formats like ones rolled out in August that let marketers buy

their own video channels or pay to place video on YouTube's popular front page.

Creating channels is a logical way to carve out space for ads, but what kinds of channels work in such a wild and woolly environment? Warner Bros. launched YouTube's first brand channel to promote Paris Hilton's new CD. But for companies that don't have content, such as a consumer-goods packager, another approach would be to create managed channels along themes—soccer, say, or anime. YouTube could use targeting technology to dish up ads based on a visitor's viewing habits. Still, marketers say they want another level of filtering. "If I buy advertising to be near humor videos, it can be risqué and edgy, but I have to be comfortable with just how risqué that is," says Jeff Lancot, general manager of online agency Avenue A/Razorfish.

## IN SEARCH OF 'NIRVANA'

ANOTHER PROBLEM is that YouTube isn't helping advertisers reach the best videos created by just folks, such as a five-minute spoof of Darth Vader as a grocery store manager. These videos are a part of YouTube's charm, but since they appear out of nowhere, it's hard to serve them efficiently. YouTube could create separate channels of the more professional videos, says Allen Weiner, an analyst at Gartner Inc. But that means pinning over the videos individually, developing technology to pinpoint content that's not pirated or from someone who is consistently good. "Until they figure out the consumer-generated content, they miss nirvana," Weiner says.

For now, YouTube's execs are resisting turning to ad pros for solutions. The company seems determined to rely on its filters to filter out pirated and vulgar works. And it's challenging marketers

to find creative ways to get into its community, such as running film festivals or sponsoring videos posted by studios.

YouTube has a head start. Still, it may have much time to turn a gusher of videos into a before being overrun by a new generation of mainstream sites and upstart Online, as in life, evolution rules. ■

## THE STAT

**100**  
Million  
Videos dished  
up by YouTube  
each day

Data: YouTube Inc.





# R&D in a global environment

## Ireland - Europe's dynamic R&D location

In Ireland, the importance of the personal touch can rarely be overstated. Human engagement is a national habit, a central part of everyday life. In recent years, Irish business leaders have adapted this natural skill to create a culture of world-class R&D.

Ireland's R&D landscape thrives on the importance of human connections. Irish business policy brings together - in a unique, no-nonsense and highly pragmatic way - a wide range of national institutions to help create leading edge research programs.

Government, funding agencies, regulatory authorities, academia and industry are constantly working as a national team, creating a fast-growing, dynamic research environment.

The result of this high-level connectivity is that Ireland has become one of the new global centers for science- and innovation-based R&D. Ireland is empowering some of the world's biggest companies to research, develop and commercialize world-class products, processes and services.

Long-established partnerships with global corporations have been at the core of Ireland's success in attracting leading edge R&D activities. Despite Ireland's small size geographically, its energetic, knowledge-based economy wins a disproportionate amount of Europe's R&D centers.

In 2005 Ireland's inward investment agency, IDA Ireland, supported 50 R&D investment projects. The past year has seen R&D announcements by many prominent global corporations. The names speak for themselves: IBM. Microsoft. Bristol-Myers Squibb. Pfizer. Citigroup. Dell. These corporations are actively supported by renowned global research organizations located in Ireland, such as Georgia Tech Research Institute and Bell Labs.

## An integrated, collaborative strategy

The Irish Government pursues a carefully planned, integrated R&D strategy encompassing all of the key elements necessary to achieve world-class R&D. Its \$5 billion Strategy for Science, Technology and Innovation will double the number of Ph.D. graduates and attract future generations of well-educated young people into research careers in knowledge-driven companies. It will substantially extend the physical infrastructure to support them. And, for the first time ever, eight government departments will coordinate all activity in relation to science, technology and innovation.

IDA Ireland is one of the main players behind the new wave of national, collaborative R&D activity. It works closely with Science Foundation Ireland (SFI), the agency which consolidates links between industrial and academic research and funds such research. IDA Ireland and SFI have developed a range of new initiatives to encourage pooled projects and attract world-class scientists to carry out research in Ireland.

This inclusive way of bringing together industry and academia has led to a boom in research projects. More than 10,000 researchers are working on cutting edge R&D projects in Ireland. Many of them have relocated from the US, Canada, Japan, the UK, Switzerland and Belgium.

Ireland's Centers for Science, Engineering & Technology ('CSETs') link scientists and engineers in partnerships across academia and industry. One such CSET is CRANN, the Centre for Research on Adaptive Nanostructures & Nanodevices. CRANN's mission is to advance the frontiers of nanoscience. It provides the physical and intellectual environment for world-class fundamental research, and has partners in Irish and overseas universities.

Ireland, knowledge is in our nature™

IDA IRELAND

"We couldn't be more delighted with the output of our research operation. The Irish Government understands the factors affecting business better than virtually any other country."

- Microsoft CEO, Steve Ballmer.





Intel is engaged in several research collaborations with leading Irish universities, including the Center for Research on Adaptive Nanostructures and Nanodevices at Trinity College Dublin.

### Tax and intellectual property

Ireland's intellectual property laws provide companies with generous incentives to innovate. The Irish tax system offers huge support to turn brilliant ideas into the finished article. A highly competitive corporate tax rate of 12.5% is a major incentive. No tax is paid on earnings from intellectual property where the underlying R&D work was carried out in Ireland.

Ireland recently introduced a new R&D Tax Credit, designed to encourage companies to undertake new and/or additional R&D activity in Ireland. It covers wages, related overheads, plant/machinery, and buildings. Stamp duty on intellectual property rights has been abolished.

### People skills

The IMD World Competitiveness Yearbook 2005 rates Ireland's education system as one of the world's best in meeting the needs of a competitive economy. In a survey of 60 countries, it ranks the Irish workforce the most flexible, adaptable and motivated.

Ireland's young workforce has shown a particular flair for collecting, interpreting and disseminating research information. Major investment in education has provided a skilled, well-educated workforce; Ireland has more than twice the US/European per capita average in science and engineering graduates.

### A track record of success

Ireland's success in R&D spans a wide range of businesses and sectors. For example, some of the most exciting Irish-based product development has been in medical technologies. Over half of all the medical technologies companies based in Ireland have dedicated R&D centers.

Boston Scientific researched and developed the world's first ever drug-coated stent using researchers in Ireland. Bristol-Myers Squibb's Swords Laboratories is the launch site for several new healthcare treatments used to treat hypertension, cancer and HIV/AIDS.

GlaxoSmithKline's latest Irish R&D project is the company's only manufacturing and development site that focuses on nanomilling technology.

Last year Microsoft marked its 20th Irish anniversary by opening a new R&D center creating 100 new jobs. The center is working on a wide range of projects, including Digital Video Broadcasting (DVB) and SmartCard security technology.

Intel, a significant supporter of education and training in Ireland, is engaged in several research collaborations with leading Irish universities including Trinity College Dublin, University College Cork and Dublin City University.

Analog Devices' long established R&D operation is heavily integrated into its Irish operation. Its 335-strong team has sole responsibility for the global design, manufacture and supply of value added high voltage, mixed signal CMOS products.



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### An exciting future of world-class R&D

Lucent Technologies' Bell Labs, one of the world's most eminent research institutions, has established its Center for Telecommunications Value-Chain-Driven Research in partnership with Trinity College Dublin. It will undertake research aimed at realizing the next generation of telecommunications networks.

Georgia Tech Research Institute's new Irish operation will be a critical component of Ireland's R&D infrastructure. It plans to build up a portfolio of research programs and collaborations with industry which at full operation will employ 50 highly qualified researchers.

Wyeth will establish a bio-therapeutic drug discovery and development research facility at University College Dublin. It will utilize new technologies to discover the next generation of therapeutic biopharmaceuticals for the treatment of a wide variety of diseases.

At an academic level, just one illustration of the integration in R&D activity in Ireland is Dublin City University's Biomedical Diagnostics Institute. It is carrying out cutting-edge research programs focused on the development of next-generation biomedical diagnostic devices.

Ireland's success in R&D is based on a culture of cooperation and collaboration to win complex, high value, sophisticated investments. The country's strong business philosophy of inclusiveness, informality and teamwork are the foundations on which Ireland has rapidly become one of the world's most exciting locations for R&D.

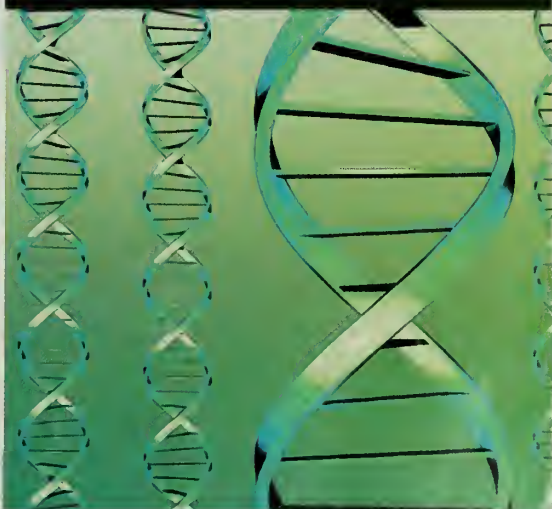
WRITTEN BY EDDIE LENNON

*"The Government's approach to science, technology and innovation will enable us to take the policy decisions which are necessary to see Ireland realize its full potential as a knowledge economy."*

- Irish Prime Minister, Bertie Ahern.

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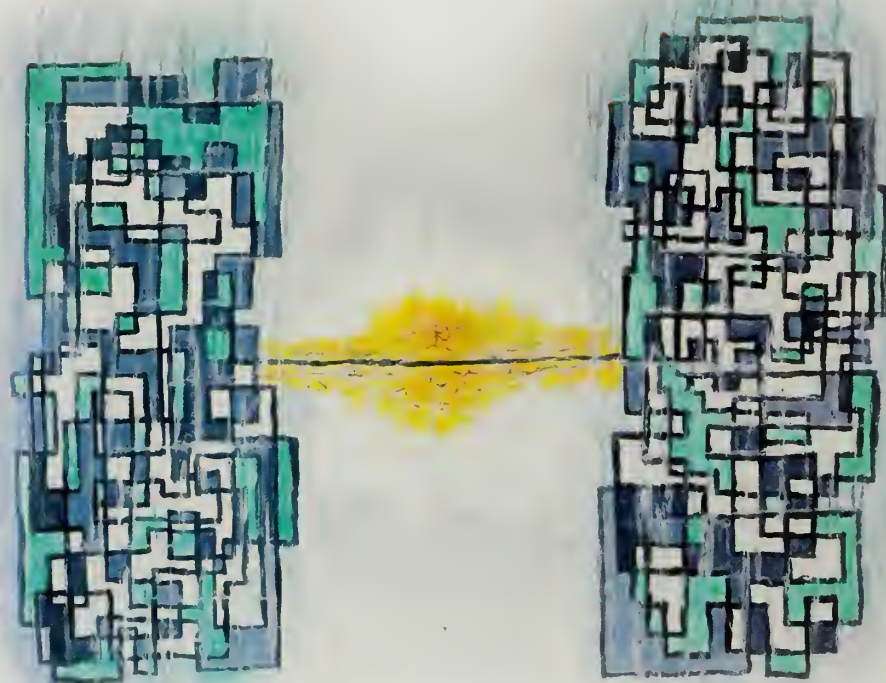
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This innate flexibility pervades the ecosystem. Nowhere else will you find such close and frequently informal links between enterprise, education and research facilities, and a pro-business Government. Connected by a dynamic information infrastructure.

It's this unique set of competitive advantages that has made Ireland one of the most attractive locations for overseas investment by some of the world's leading technology companies. Amongst them are Intel, Microsoft, Dell, Hewlett-Packard, Oracle, SAP, eBay and Amazon.com

The Irish mind, with its innate knowledge and flexibility, can be the pathway to profit for your technology business. **To learn more, contact the Irish Government's inward investment agency, IDA Ireland, 345 Park Avenue, New York on 212 750 4300, email [idaireland@ida.ie](mailto:idaireland@ida.ie) or log on to [www.idaireland.com](http://www.idaireland.com)**

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# Put Your Money Where Your Mouth Is

Safeway wanted a fresher, healthier image. The first step was to become fresher and healthier

BY JUSTIN HIBBARD

**I**N 2002 THE MANAGEMENT TEAM at Safeway Inc. got ice water splashed in its face. After boosting annual earnings at double-digit rates throughout the '90s, the third-largest U.S. supermarket chain reported its first annual loss since going public in 1990. "We needed some fundamental changes," says Steven A. Burd, chairman and CEO of the Pleasanton (Calif.) company. "We [needed to] differentiate our offering from other conventional supermarkets."

Those supermarkets were fast becoming

an endangered species. Big-box retailers such as Wal-Mart Stores Inc. were preparing to invade the low end of the grocery market and win on price. Specialty stores such as Whole Foods Market Inc. were conquering the high end with quality and atmosphere. That left traditional grocers like Safeway getting squeezed in the middle.

To escape, Safeway had to pull off a challenging feat. While continuing to offer popular food brands at low prices, it had to add higher-quality fare and transform its sterile aisles into a more stylish environment. Most important, con-

sumers had to believe the change was for real, not just window-dressing. That's a tall order for an 80-year-old retailer whose customers associate it with fluorescent lighting and Oreos. So the company used what management gurus call authentic marketing: the art of telling consumers a story they want to believe, then delivering the products and experience that make the story real.

The project is the largest remodeling effort ever undertaken by a U.S. supermarket chain. Beginning in 2003, Safeway committed to spend \$1.6 billion a year over six years to remodel all 1,775 of its stores. The company also resolved to pare back labor costs, which led to strikes and lockouts. In the end, Safeway got most of the cuts it wanted, but the negative publicity stung. Now, in concert with the company's \$100 million ad campaign, things are starting to turn around. Identical-store sales growth has swung from -4.5% in 2003 to 4.3% last year. After reporting losses in 2002 and '03, the company is expected to earn \$822 million on \$40 billion in revenue this year, up 42% from 2005, according to consensus analyst estimates from Reuters Group PLC. In the past 12 months, Safeway shares have risen 31%, to 31.

Authentic marketing may seem a fancy term for a simple idea: Deliver what

## Supermarket Makeover

Profits have been soaring since Safeway reinvented its look. Here's what the company did:



**WALLS** Earthy tones replaced plain, old white to convey freshness and wholesomeness.

**LIGHTING** Switched glaring lights for warm accent lights that direct attention to products and departments.

**SIGNAGE** Big pictures of healthy food went up. Display stations throughout stores suggest meal ideas for time-starved shoppers.

**PRODUCE DEPARTMENT** Enlarged organic section, moving it from case against wall to wooden crates at center of floor, suggesting a farmer's market.

**FLOORS** Installed hardwood floors in perishables departments to provide a natural feel.

**BAKERY** Knocked down wall to show off bread baking in wood-fired oven. Added island in center of department that offers custom bread slicing.





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An approach in which software unifies your people, processes and technology to increase efficiency and optimization. Only one global software company can do that. CA, formerly known as Computer Associates, has focused solely on IT management software for over 30 years.

The technology vision that makes this promise real is called Enterprise IT Management, or EITM. At its heart is the CA Integration Platform - a common foundation of shared services that gives you real-time, dynamic control and flexibility. Its greatest benefit? CA software solutions come to you already integrated, and able to integrate with your existing technology to optimize your entire environment.

Ultimately, well-managed IT gives you the visibility and control you need to manage risk, manage costs, improve service and align IT investments. To learn more about how CA and our wide array of partners can help you unify and simplify your IT management, visit [ca.com/unify](http://ca.com/unify).

promise. But history has shown that living up to that precept isn't easy. In 1985, the Great Atlantic & Pacific Tea Co., better known as grocery chain A&P, launched a glitzy ad campaign that declared: "We Built a Proud New Feeling." But shoppers got the same old feeling when they visited stores and found little that had changed. Sales barely budged.

## TRUE STORIES

WHAT DID Safeway do right? The short story is that it delivered before it promised. "We were very careful not to talk about quality until we had stepped up quality," Mulder says. That way, when Safeway told a story about quality in a TV ad, customers could walk into a store that they could see and taste the quality, leaving no doubt about the story's truth.

Before writing a word of marketing copy, Safeway studied its customers. They needed the wholesome food and pleasant environment of specialty stores but also wanted their favorite brands and low prices. Safeway saw that it could quickly distinguish itself with higher-quality perishables. Without fanfare, the company in 2003 and 2004 introduced more tender beef, sweeter apples, and fresher bread until it had upgraded all its perishables departments. Safeway was careful not to oversell the information. Today, when customers enter its Danville (Calif.) store, they might be greeted not only by a bin of designer Valencia cantaloupes but also by a stack of Gatorade bottles on sale. The message? Shoppers can get the familiar brands and bargains they expect, as well as items they might associate with natural foods stores.

Brian C. Cornell, Safeway's chief marketing officer, calls it "completeness."

Once Safeway had improved perishables, it hired Novi (Mich.) retail design firm Orangetwice, then known as Avizia, to dream up a new environment. The firm's clientele has ranged from clothiers Barneys New York and Polo Ralph

wooden letters were attached to walls to spell out slogans such as "Fresh from the fields." The floral department increased the number and variety of flowers it stocked and added items such as scented candles and vases. Muller says it's doing 90% more business in the same space.

Not until the food quality and store environment were battle-tested did Safeway prepare an ad campaign. Its agency, Dailey & Associates Advertising of Los Angeles, conjured an "ingredients for life" slogan to suggest not only that people might live healthier if they buy Safeway's food but also that the food is designed for the way people live today. Dailey's TV commercial showed a diverse group of people eating food on the go. Safeway then put graphics from Dailey's ads on its trucks, shopping bags, aprons—on any real-life artifact that

could make the story palpable.

The moral of Safeway's tale? A compelling story is key to authentic marketing. Safeway's consumers don't just want cheap household goods—they want to be part of a story about a healthy modern lifestyle. "The marketer's job is not to focus on facts but to present a story to people that they want to believe," says Seth Godin, author of *All Marketers Are Liars: The Power of Telling Authentic Stories in a Low-Trust World*. "You can make up a story, but when people visit your store, if the story is inauthentic, then people reject you and don't trust you again." That could be the costliest makeover of all. ■

## PLAYBOOK: BEST-PRACTICE IDEAS

### The Secrets of "Authentic Marketing"

#### TELL A TRUE STORY

■ Consumers don't just want to buy a widget or save a buck. They want products placed in a meaningful context—a story. Marketers don't always have to focus on facts, but their stories must hold up when consumers get the goods.

#### DELIVER, THEN PROMISE

■ A brand is a promise. When you tell consumers your brand stands for something, you had better be ready to deliver that special something. Safeway spent three years improving food quality before it rebranded the company.

#### DON'T OVERSELL

■ It's fine to add new meaning to an existing brand if you can deliver. But throwing out the old meaning in a radical about-face can seem fake. When Safeway extended its brand, it was careful not to climb too far upscale.

Lauren to Total Convenience Stores. Orangetwice was brutally honest about authenticity. "We said, 'What you are marketing you'd better deliver,'" says Liz Muller, chief creative officer. "Otherwise, you actually do more damage."

Orangetwice's mandate was to create an experience that would make Safeway's story about quality and wholesomeness believable. "We wanted to make sure when you walk into the store it gives you a natural, abundant, fresh feeling," Muller says. The firm replaced glaring lights with warm accent lights. Dull white walls got painted earth tones—no store surface was left white. Hardwood floors were laid in the perishables departments, and

## For DHL, the power of IT delivers over four million promises a day.

The best way for this world leader in delivery services to move more packages is to move more information. CA software solutions enabled DHL to unify and simplify its global package tracking system. The increased efficiency gives DHL the ability to handle more packages more accurately. With CA's help, DHL put the customer service back in shipping as it delivers on over one billion promises each year.

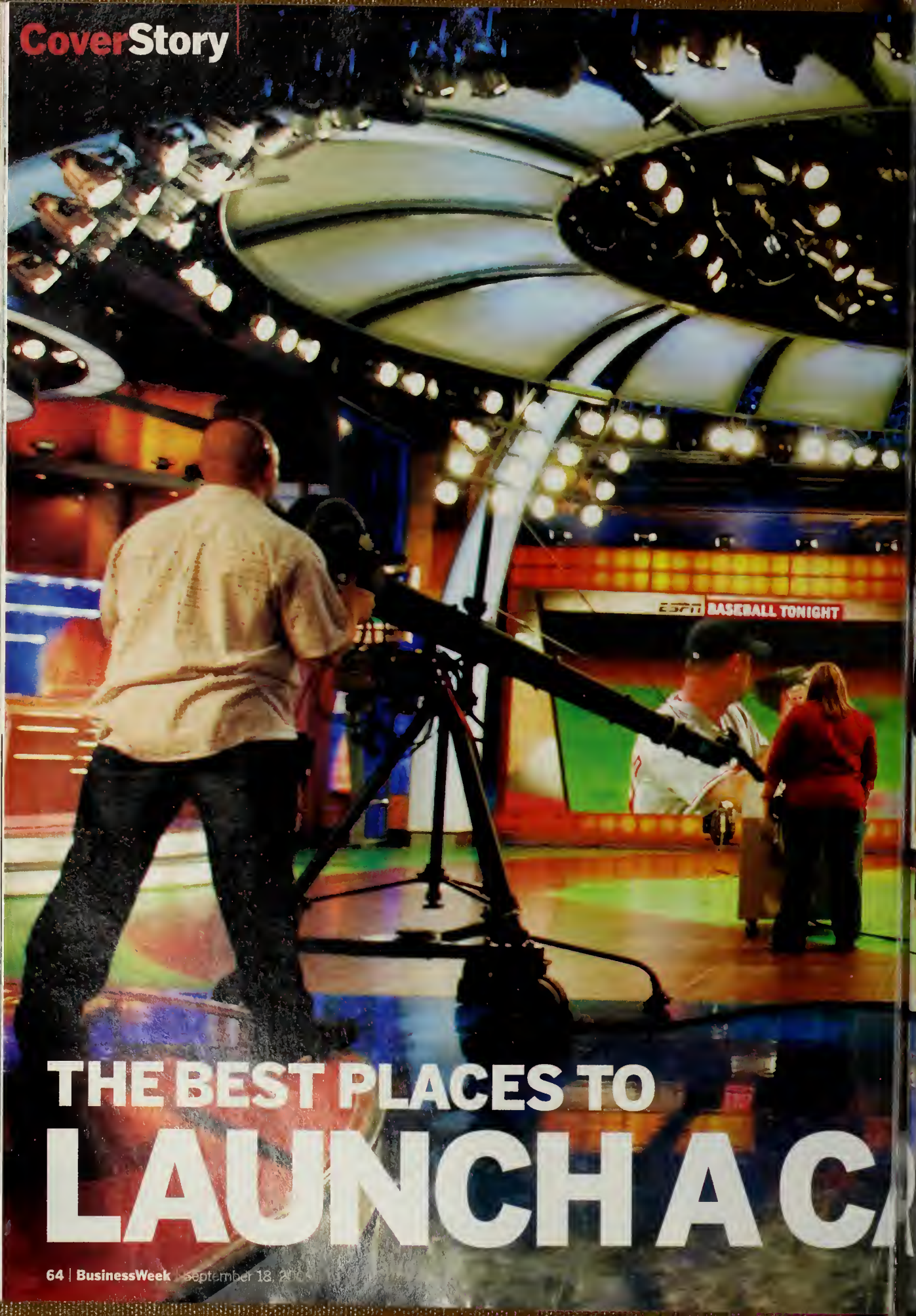
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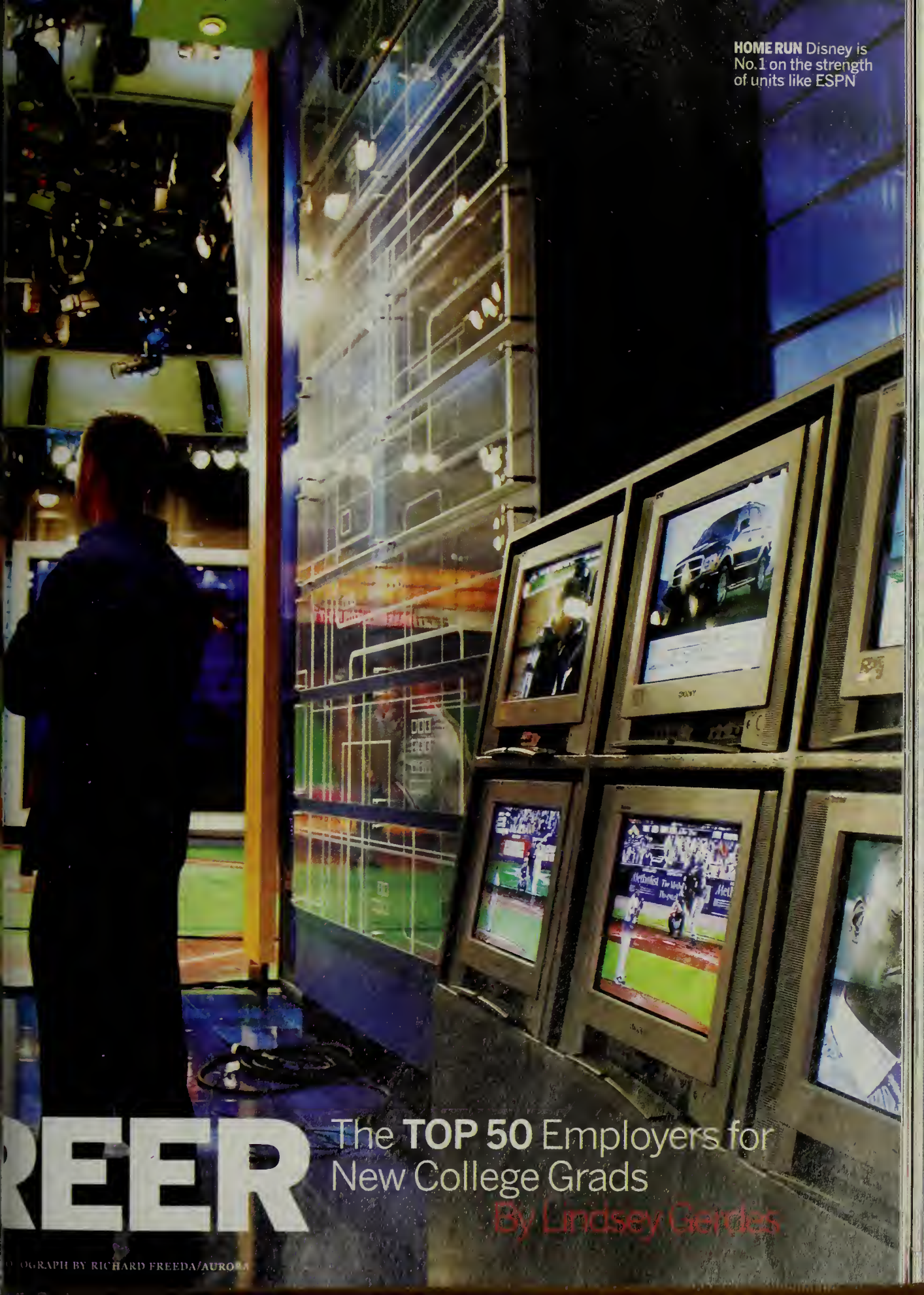






# THE BEST PLACES TO LAUNCH A C





**HOME RUN** Disney is  
No.1 on the strength  
of units like ESPN

**CAREER**

The **TOP 50** Employers for  
New College Grads

By Lindsey Gerdes



# CoverStory Best Places to Launch a Career

**L**IKE MANY OTHER BASEBALL fans, Joe Kosa, 28, is spending his Sunday glued to a TV. But relaxed he's not. Instead, the ESPN production assistant is stationed in front of dozens of flat-screen TVs tuned to global sporting events at the headquarters of the Disney-owned network. He's furiously jotting down notes to weave into a storyline that will be read in 60 seconds flat on tonight's 6 p.m. *SportsCenter* broadcast.

With the San Diego Padres leading the Chicago Cubs 9-0, the outcome is hardly in doubt, and writing the highlights should be easy. Then, Clay Hensley, who has pitched a near-perfect game for the Padres, steps up to the plate in the ninth inning and strikes out for the fifth consecutive time, possibly tying a Major League record. With an hour to go until showtime, Kosa confirms the dubious honor, then rushes to the edit room to compile clips of each and every strikeout for his account of what are simultaneously the pitcher's best and worst nine innings. During the first commercial break, he debriefs anchor Dave Revsine. Moments later, Revsine is reading Kosa's script to more than a half-million viewers. "It keeps you on your toes," says Kosa, who was promoted three times in his three years at ESPN. "You'll never come in to work and have the same experience twice."

## Have It Your Way

IT'S OPPORTUNITIES like these, combined with a fast-paced business such as Bristol (Conn.)-based ESPN, that have helped catapult Walt Disney Co. to the No.1 spot on *BusinessWeek's* inaugural "Best Places to Launch a Career" ranking. Disney's strong on-campus recruit-

ing, solid benefits, and collaborative culture also helped land the entertainment giant at the head of the rankings, which identify top employers for new college graduates. Disney's place at the pinnacle is also a testament to its popularity with

students, but its desirability goes well beyond the company's instant national recognition. In many ways, Kosa's experience at ESPN, where he enjoys exciting high-pressure work, rapid advancement and immediate impact, is the new American workplace writ small. B

cause if members of his generation have their way—and they will—there will be a lot more employers like ESPN.

With this ranking, *BusinessWeek* has put together a guide to the employers that really shine. Unlike other such rankings, *BusinessWeek's* incorporates feedback from three different sources. First, we surveyed directors of undergraduate career services to find out which employers were creating buzz on campus. Next, we asked those finalists to complete a questionnaire about pay, benefits, retention, and training programs, which we then compared with other employers in the same industry. Finally we asked University Communications to supply data from its survey of more than 37,000 U.S. undergrads about their finalists at the top of their list of most desirable employers.

The findings are often surprising. It's now clear, for instance, that to attract the best and brightest, companies are no longer competing only with others in their industry. More open to career experimentation than previous generations, college grads are applying across a swath of industries. The result: No.4-ranked Goldman Sachs could just as easily be vying with No.43 Teach America and No.13 Google with No.9 JPMorgan and No.2 Lehman Brothers for the v



Lockheed goes after scarce engineers

## The Envelope, Please

*BusinessWeek's* Top 10 employers for new college grads. For the complete list, see pages 78-81.

- 1 Disney
- 2 Lockheed Martin
- 3 Deloitte & Touche
- 4 Goldman Sachs
- 5 Enterprise Rent-A-Car
- 6 State Dept.
- 7 Raytheon
- 8 General Electric
- 9 JPMorgan
- 10 Abbott Labs

flatter

flog

# IF YOU'RE A JOCK, YOU ROCK

BY JOHN DeBRUICKER

**F**ive months ago, Gretchen Tonnesen was carrying the ball, analyzing defenses, and leading her teammates as a flying halfback and captain on Princeton University's women's rugby team. And she was doing it all on a wobbly knee, following six months of rehabilitation after a painful injury. Today, her team is JPMorgan Chase & Co., where she's equally busy scrutinizing technology, media, and telecommunications companies for the investment bank.

Tonnesen, who majored in religion, was chosen not so much for her academic interests as for her proven passion for rugby. Recruiters are noticing that college athletes have a slew of qualities that not only lead to business success but are also often lacking in new recruits: leadership, competitiveness, and an almost obsessive focus on goals. Such employees can have the drive and stamina that make them near-perfect matches for the 80-hour high-pressure workweeks of many Wall Street jobs. "I love the work," says Tonnesen. "I love the fast-paced atmosphere."

Tonnesen is one of many young professionals who have come to Wall Street by way of the Alumni Athlete Network, founded by former Harvard University basketball captain Ronald P. Mitchell. Each year the program whittles roughly 500 applications from college athletes down to 150 interview candidates, of which about 45 are placed in internships at banks such as Citigroup, Goldman Sachs, and Merrill Lynch, among others. The best part: A remarkable 87% of the interns, like Tonnesen, go on to land full-time jobs on the Street.

Scott Harrington, managing director at JPMorgan and sponsor for the Alumni Athlete Network, believes the program is a great opportunity for the firm to hire talent that is both driven and diverse. Title IX, the 1972 law that prohibits educational discrimination based on gender, may be responsible for some of that mix. In fact, few



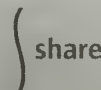
**"I love the work. I love the fast-paced atmosphere"**

talent pools are as diverse as those of student athletes. Says Harrington of the former jocks: "We have more breadth in recruiting than we ever had before."

When Mitchell created the network, he knew that student athletes like himself would make good matches for the intense environment. Team responsibility, time management, and dedication all go a long way in the industry, and student athletes have these virtues in spades. "There is a winner and a loser every day on the trading floor," he says. And the dumb-jock stereotype? Forget it. Students in the program have an average GPA of 3.6 and an average SAT score of 1320—that's 300 points higher than the national average.

## SHARE YOUR THOUGHTS.

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same applicant. The intensely competitive market for top young talent means companies have to fine-tune their game. Consider No. 2 Lockheed Martin Corp. Starting three years ago, the giant defense contractor made a big push to boost its appeal to undergrads, particularly the shrinking pool of U.S. engineering students. Based in part on input from focus groups, it stepped up recruiting, increased vacation time, and improved its mentoring program. In 2005, the number of applications for entry-level positions nearly tripled.

## Networkers

LIKE THE BABY BOOMERS and Generation X before them, a new generation known as the Millennials, nearly 80 million strong, is just now starting to reshape the American workplace. Achievement-oriented and tech-savvy, the Millennials are eager for feedback and impatient to make an impact on their new organizations and on society at large. Networked in a way previous generations were not, thanks in large part to Internet phenomena MySpace and Facebook, they come equipped with many of the skills required by big employers, such as computer fluency and a knack for teamwork. But the same social networking skills and consumer smarts that make them valuable employees also make them acutely discerning job seekers.

Confronted with this demanding generation, also sometimes known as Generation Y or the Echo Boom, companies are scrambling to attract and retain the most talented among them. Some executives say they are offering entry-level employees more variety and challenges, providing senior-level mentoring, and even giving them opportunities to work for causes they believe in. Granting more competitive pay and benefits, faster career advancement, and more responsibility means taking big risks with the greenest employees on the payroll. Says Claudia Tattaneli, chief executive of Philadelphia research

## NO.13 GOOGLE

### THE SEARCH ENDED HERE

**S**ome entry-level employees get all the breaks. Others make their own luck. Salar Kamangar did both. He joined Google Inc. after graduating from Stanford University in 1999, five years before the initial public offering, and his meteoric rise mirrored the company's own comet-like trajectory. In seven years, Kamangar now 29, has gone from newbie to key player in one of the most remarkable corporate success stories of the decade. Among his accomplishments: writing the first business plan, becoming a founding member of the Google product team, and leading the engineering team that launched AdWords, Google's proprietary method for tailoring Web ads to search terms. Google's youngest vice-president talked with *BusinessWeek's* John DeBruicker about what makes Google one of the best places for entry-level employees.

#### You were a biological sciences major. How did you get into technology?

When I first [got] to school, I was passionate about the idea of being a doctor until I spent some time watching doctors working with patients. I was then passionate about the idea of being a scientist. But I realized the day-to-day wasn't exciting. Then, after spending two weeks part-time at Google, I found I was energized by the tasks involved in the job. The lesson learned was to make sure you're excited and passionate about the day-to-day and not just the idea of the job.



#### What's it like being the youngest vice-president?

I don't think about the "youngest" part. We have a startup mentality with the resources of a larger company. I think that's very important. If you're a college grad going into your [first] job, you don't want many, many levels of hierarchy [where] you feel like even if you have a lot of passion and energy it doesn't get channeled effectively.

#### Would your experience have been different had you joined Google later?

I was able to progress more rapidly because I got started early. A new employee [today] wouldn't have the same experience I did. Relative to nonstartups, Google is very much a place where you can quickly make a big difference and be noticed.

#### What is your favorite part of the job?

It's fun to be in a room with a bunch of creative people and be as contrarian and as outside-the-box as possible, while talking about how to take an existing product or business and make it better.

#### What would your advice be to a recent grad beginning the job hunt?

After finishing your education, don't worry about finding the perfect role at the perfect company, because odds are low that you'll be a

**"We have a startup mentality with the resources of a larger company"**

to predict anything. Instead try to find the perfect industry—you'll be in a much better position to identify, and end up in, the perfect company. It's usually futile to try to predict next Google. I lucked out, but I was able to identify the kind of industry that would matter and grow the fastest.

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firm Universum Communications, which surveys Millennials: "The challenges are a completely different set than they were two, three, or six years ago."

## Revolving Door

GIVEN THE COUNTRY'S demographics, some accommodation is inevitable. Entry-level hiring is expected to surge in 2007 by more than 17%, the fourth consecutive double-digit increase, according to the National Association of Colleges & Employers (NACE). And this could be only the beginning. By 2010, as the exo-

dus of baby boomers from the workforce accelerates, census data suggest, two employees will be leaving for every new hire entering, and new college grads will be a precious commodity.

The numbers demonstrate only half the challenge. In crafting the perfect pitch these days, it's not enough to have a marquee name or competitive pay, although those certainly help. To land the most desirable young grads, employers need to put something far more valuable on the table: the organization itself. Companies with corporate cultures that stress social responsibility, diversity, and

the environment, all values that align with those of the twentysomething generation, stand to get the lion's share of interest from job seekers.

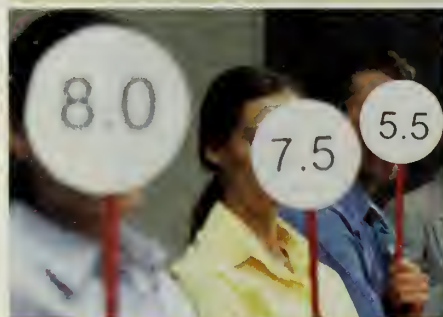
Some of the old recruiting orthodoxies are rapidly disappearing. Financial services companies, once the refuge of business majors and quant jocks, now accept liberal arts grads in droves even if means a bigger up-front training investment to get them up to speed. Almost half of entry-level hires at Lehman Brothers and JPMorgan and a third of those at Goldman Sachs fall into this category.

In this rapidly shifting environment

## PLAYBOOK: BEST-PRACTICE IDEAS

# Bait for the Brightest

As boomers begin retiring en masse, recruiting and retaining young talent is more important than ever. A step-by-step guide to attracting members of today's high-maintenance Millennial generation:



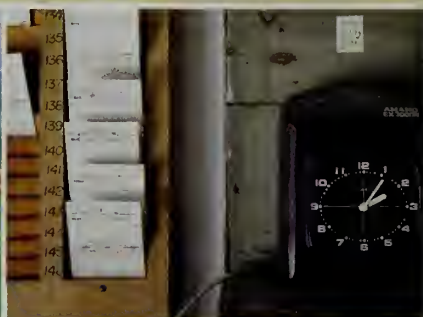
### DON'T FUDGE THE SALES PITCH

High-tech presentations and one-on-one attention may be attractive to undergrads, but the pitch better match the experience. Today's ultra-connected students can get the lowdown on a company by spending five minutes on a social networking site.



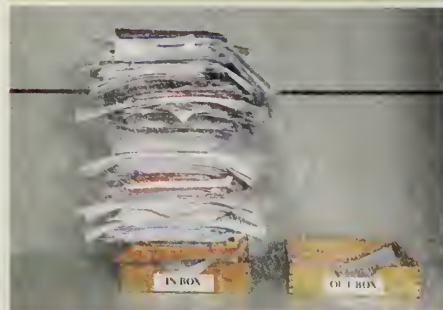
### LET THEM HAVE A LIFE

Wary of their parents' 80-hour workweeks, Millennials strive for more balance, so liberal vacations are a must. They also want assurances they'll be able to use it. At KPMG, 80% of employees used 40 hours of paid time off in the six months through May.



### NO TIME CLOCKS, PLEASE

Recent grads don't mind long hours—if they can work them on their own time. Lockheed Martin and the Comptroller of the Currency allow employees to work nine-hour days and take every other Friday off. Merck has a generous job-sharing program.



### GIVE THEM RESPONSIBILITY

A chance to work on fulfilling projects and develop ones of their own is important to Millennials. Google urges entry-level employees to spend 20% of their time developing new ideas. PepsiCo allows promising young employees to manage small teams in six months.



### FEEDBACK, AND MORE FEEDBACK

Career planning advice and frequent performance appraisals are key to holding on to young hires. Lehman Brothers provides new hires with two mentors—a slightly older peer to help them get settled and a senior employee to give long-term guidance.



### GIVING BACK MATTERS

Today's altruistic young graduates expect to have opportunities for community service. Wells Fargo encourages its employees to teach financial literacy classes in the community. Accenture and Bain allow employees to consult for nonprofits.



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many employers have seized the chance to distinguish themselves from the pack. Among the best 25 employers in the ranking are some that may not seem as if they would be hot with the graduating set, but they offer superior perks. Raytheon's hefty pay packages, Verizon Communications' benefits, and National Instruments' training budget helped propel those companies to the top. More and more, companies will be forced to match similar enticements. Universum Communications, which supplied student survey data for the ranking, says that the number of corporate clients seeking research on the Millennials and their attitudes has increased 45% in the past six months alone. "Half of that is from clients who are usually only focused on MBA recruiting," says Universum's Tattanelli. "They're now interested in creating a strong employer brand image early on."

## Coddled

SO WHO ARE these challenging Millennials? Researchers note that unlike the Gen Xers before them, who were the "latchkey kids" of the 1970s, many of these recent grads have grown up in households with actively involved parents and a strong support network in place. Coddled from an early age, as employees they are sometimes perceived by older colleagues, rightly or wrongly, as lacking a strong work ethic and having an unjustified sense of entitlement. With their overscheduled childhoods, many are also viewed as being unable to think on their feet, solve problems on their own, or take on leadership roles.

On the positive side, getting the job done well and efficiently is important to Millennials, say their employers. Boomers, by contrast, logged long hours and seemed to view face time as an end in itself. Teamwork and collaboration are this group's strong suits. "Traditional career ladders are still important today," says Anne Ceruti, vice-president for talent acquisition at Disney. "But collaboration is so much more important [to them] than it was for previous generations."

The most important thing employers need to know about Millennials is this: They can afford to be choosy. According to WetFeet Research & Consulting in San Francisco, the number of entry-level job seekers receiving multiple offers has been on the rise for five years, and 82% are

confident they will find the job they want. The competition is driving up pay. The average increase for U.S. employees in 2006 is 3.6%, but starting salaries for some new college grads outpace that. The average offer for civil engineering graduates, for one, is up 5.4%, to \$46,023; that for

## NO.5 ENTERPRISE

# A CLEAR ROAD TO THE TOP

BY PAULA LEHMAN

**N**ot even the CEO's son gets off the hook. When he was 16, Andrew C. Taylor walked into his dad's office at Enterprise Rent-A-Car with his sleeves rolled up, ready for work. The tools? A bucket of soapy water and an oversized sponge. That was 30 years ago. Now Taylor is the chairman and CEO of Enterprise, and he's a long way from cleaning windshields.

The clearly defined path from the bottom to the top helps explain why Enterprise fared so well in *BusinessWeek's* "Best Places to Launch a Career" ranking. Even though the pay among the lowest on the list—less than \$35,000, on average—Enterprise offers a unique training opportunity for entry-level hires. Management trainees start at the bottom, learning every aspect of the business, but those who catch on quickly get a chance to run a branch office, where they're responsible for everything from ordering office supplies to hiring and firing employees. "Everyone here looks at you as future management potential," says

Stephen Cullen, an assistant manager in Fort Pierce, Fla. "Your goal is to get everyone under you promoted."

When Cullen came to the company last December, he enrolled in a four-day crash course that focused mostly on company culture. But the real training takes place on-site. Enterprise's more than 6,500 branch offices worldwide, where management trainees are assigned. Training usually lasts 8 to 12 months and can include helping customers, dealing with body shops, and, yes, washing cars. Sarah Ruddell, an assistant manager in Rockville, Md., says the variety forces you to think on your feet: "At Enterprise, I get to work on customer service, marketing, sales. You're not stuck doing the same thing over and over again."

After a year, promotions nearly always follow—first to management assistant, then to assistant manager. It is at this stage that employees begin to supervise and mentor others and become eligible to serve as branch managers, overseeing the office's workforce, rental fleet, and finance and they're expected to turn a profit. Within five years most go on to take positions at headquarters or become area managers, responsible for all branches in a given region.

The training program doesn't always go without a hitch. In June four assistant managers sued the company in federal court, alleging that they were classified as "exempt"—and therefore denied overtime pay—even

though their job duties included many normally performed by nonexempt workers, such as picking up customers and working the counter. Enterprise says the

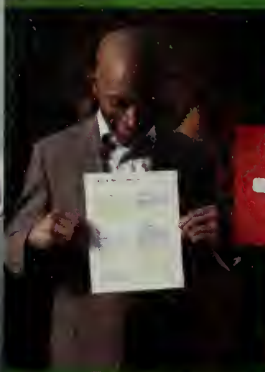


**"You're not stuck doing the same thing over and over again"**

suit is "without merit" and that it has no intention of changing the training program, which has been in place since 1957, when the Taylor family started the business. "What's unique about our company is that everyone came up through the same system, from the CEOs down," said Patrick Farrell, vice-president for corporate communications; "100% of our operations personnel started as management trainees."



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accounting graduates has jumped 5.5%, to \$45,656, according to NACE.

If one thing sets apart the Top 50 employers in the *BusinessWeek* ranking, which spotlights not only companies but also government agencies and nonprofits, it's their ability to give entry-level employees new opportunities early and often. Among the highest-ranked 25, for example, 21 provide extensive training programs that will hone workers' skills and help advance their careers. "The issue for younger people thinking about their careers is whether [an employer is] an organization that's going to develop them and provide a platform for other opportunities," says Tom Tierney, the former CEO of No. 17 Bain & Co. who

now runs Bridgespan Group, a consultancy for nonprofits.

Increasingly, the most popular and effective recruiting strategy is the use of internships. To identify promising recruits early and to sell them on a company at the same time, more employers are looking to their intern pool to fill full-time slots. Among employers that supplied internship data, nearly half increased their reliance on interns since 2004; at six companies on the list, more than 50% of the 2006 entry-level hires were former interns. At No. 4-ranked Goldman, that figure was 51%, up from 38% in 2004. "It's really the primary driver of our recruitment," says Aaron Marcus, Goldman's global head of recruiting.

Companies facing increased competition for interns say they are giving them the one thing they crave more than money: responsibility. At L'Oréal Group, one intern represented the company at charity event; at Abbott Laboratories, instead of fetching coffee for higher-ups as at some placements, Fabiola Salcedo, 23, conducted a detailed analysis of imports and presented her findings to senior executives. "[I chose Abbott] primarily because of responsibilities I was given when I interned here," says Salcedo, who joined the company full-time last year. "I felt like I was really part of the department."

Employers are also getting more creative with the tactics they use to dra

## NO.6 STATE DEPT.

### THE EVOLUTION OF A DIPLOMAT

BY PAULA LEHMAN

**I**f you're a college grad, how do you get to an exotic U.S. embassy? Practice, practice, practice.

Or at least that's how the U.S. State Dept. turns you into a diplomat. Two unique aspects of the State Dept.'s training program are foreign travel and simulations designed to give Foreign Service officer candidates a feel for the day-to-day work in U.S. embassies and consulates abroad. The training also includes as much as a year of classroom lectures, study, and language training before new officers board a plane to their first foreign posting. Even before training begins, though, would-be diplomats must pass the highly competitive Foreign Service Exam.

During their time at the training facility in Arlington, trainees go through a series of simulations that mimic typical experiences they might have overseas. One involves visiting a morgue to identify a corpse—a real one. Another includes a pretend visit to U.S. citizens in a foreign jail, where the trainee practices calming the detainees, describing what will happen next, and working with local authorities to make sure the Americans are being treated fairly.

Those who have been through the simulation say it works. Four years ago, as a 26-year-old newly deployed Foreign Service officer, Clayton Bond marched into a Barcelona jail to help two Americans arrested on drug charges. He knew exactly what to do because he had done it before, in a fake jail cell. It's the kind of preparation the job demands. Says Bond: "You're right on the front line."

Corporate training programs may expose trainees to different divisions of a company, but at the State Dept. trainees rotate around the globe in different country assignments. They perform three years of consular work abroad, where they could be stationed anywhere from Afghanistan to Zimbabwe. As part of their duties, the trainees interview visa applicants, find lawyers for U.S. citizens in trouble, and replace lost passports. The training is pretty much 24/7. "We encourage diplomats to get out and do things in the country—learn the language, the culture," said Robyn Hinson-Jones, coordinator for the department's Diplomat in Residence program. "There is no shortage of opportunities to meet people."



### In handling emergencies for Americans abroad, "you're right on the front line"

After two years at their first posting, trainees go on to their second. In all, they serve in as many as three locations over five years. At least one will be a "hardship" post, where living conditions are difficult or downright harsh. The most dangerous locations, such as Rwanda—still suffering from a legacy of genocide and war—come with a pay premium of up to 25%. Small compensation perhaps, but for aspiring diplomats, an invaluable experience.





**Corner Office**





these young candidates for both internship and entry-level positions. Accenture, ranked No. 20, advertises on coffee sleeves on select campuses and holds raffles via text-messaging to publicize career opportunities. Google feels students themselves can be the best recruiters. The Mountain View (Calif.) tech juggernaut recruits engineering undergraduates on roughly 80 U.S. campuses to serve as "pizza ambassadors," providing classmates with pizza on Google's dime during exams. JPMorgan Investment Bank runs an interactive derivatives trading game to identify top talent. It has taken on a viral life of its own: When the bank

advertises the "Fantasy Futures" game at one school, participation surges at other campuses in the area.

If recruiting is employers' first hurdle, retention is by far the highest. Those employers who provided the data reported that more than one-third of their new hires bolted within three years. And replacing them isn't cheap. Training costs averaged nearly \$10,000 a head, which can add up quickly when you're hiring more than 1,000 college grads each year, as more than one-third of the ranked employers do.

The main reason young employees are heading for the exits, oddly enough, is

the very thing boomers thrived on: perpetual work day. Having grown up with parents who wore a grueling work week as a badge of honor but were permanently sleep-deprived because of today's young professionals are pushing for a more balanced life. Of the 37,000 plus undergraduates surveyed by Universum this year, the No. 1 career goal was to "balance personal and professional life." "Building a sound financial base" ran a distant third, in part perhaps because young people are waiting long to buy homes and start families.

To get the best hires to stick around, companies are more likely to provide

## IDENTIFYING THE IDEAL EMPLOYER

**C**hoosing an employer after college is an intensely personal process. A company that's perfect for one job seeker may be perfectly wrong for another. But even if priorities differ, all job seekers care about many of the same things: pay and promotions, corporate culture, and training programs, to name a few. It's these attributes of a workplace *BusinessWeek* has undertaken to measure with its inaugural ranking of the Best Places to Launch a Career.

To start, *BusinessWeek* turned to a group of people who stand at the intersection between the classroom and the cubicle: the nation's career services directors. In March we conducted a nationwide survey of directors at top colleges and universities, public and private, in every academic discipline. The survey asked the directors to identify the top five employers for entry-level workers in a dozen industries, and the top 10 employers overall. Of the 110 directors surveyed, 40 replied, for a response rate of 36%.

Using the survey data, *BusinessWeek* constructed a list of more than 100 companies, nonprofits, and government agencies that were eligible for the final ranking. This was a two-step process. The first step involved identifying the five high scorers in each industry. For every career services director who ranked a company No. 1 in its industry, the company received five points. Every No. 2 ranking was worth four

points, every No. 3 ranking was worth three points, and so on. After tallying the points, including ties, we had a total of 61 companies. To flesh out the list, we reviewed the remaining companies suggested by the career services directors and identified those with the highest industry point totals among all the industries. That added a further 43 employers to the list, for a total of 104.

Next, we invited each employer to answer an extensive survey seeking information on hiring, pay, benefits, training programs, and retention. Of the 104 organizations, 55 completed the survey, for a response rate of 53%. We then compared each employer with other

### We started with more than 100 companies then winnowed the list by combining survey replies from three different groups

its industry. For each ranking question, the best response, such as highest pay or retention rate, was awarded 10 points. The worst response, or no response at all, received no points. Points awarded others depended on the number of employers in that industry.

To complete the ranking, we combined the results of the employer survey with two additional pieces of data: From the survey of career services directors, we tallied the points for each respondent's overall ranking of employers—10 points for each No. 1 ranking, nine points for each No. 2 ranking, and so on. And from Universum Communications Inc., a Philadelphia researcher that surveyed 37,000 U.S. undergraduates this year, we received the percentage of students who listed each employer among the five for whom they would most like to work.

If no career services director included an employer among the top 10 overall, or if no student survey data were available, such employers forfeited the 25% associated with that survey. If data from both surveys were unavailable, the employer was placed at the bottom of the ranking, with its place determined solely by the employer survey.

—By Louis L.

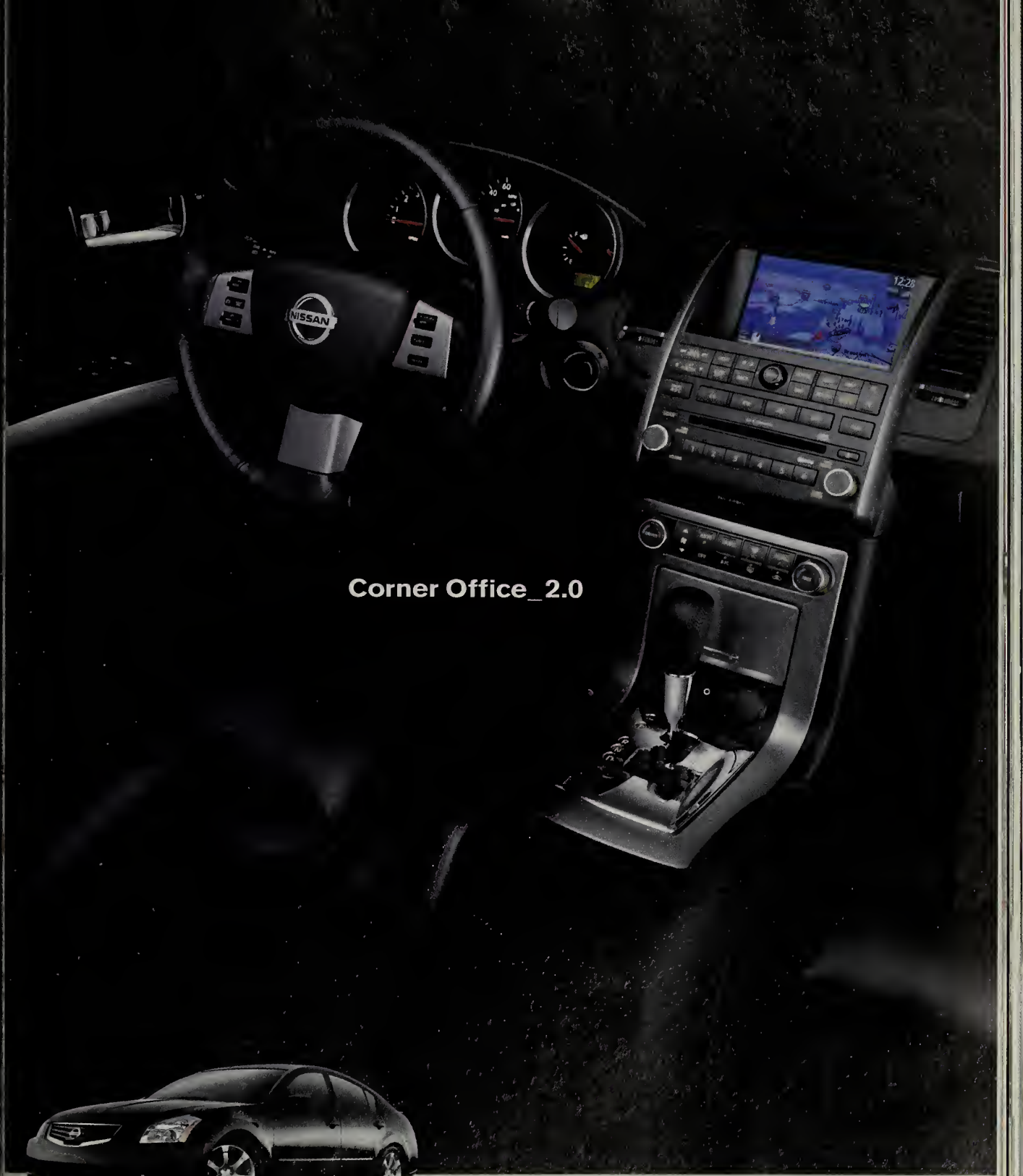
### How We Ranked Them

To determine the best of the best, *BusinessWeek* used three sources of data:

**1. SCHOOLS** To narrow the field, we surveyed career services directors at more than 100 colleges and universities. Their top picks became our finalists. Contribution to final ranking: 25%.

**2. STUDENTS** Universum Communications, which surveys undergrads, supplied the percentages of students who included each finalist among their most desirable employers. Worth 25%.

**3. EMPLOYERS** All finalists then filled out a survey on pay, benefits, corporate culture, and training programs. Each employer was compared with others in its industry. Contribution to final ranking: 50%.



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measure of freedom from cubicle life and offer everything from comp time to flexible work schedules. Those that don't are paying a price. For years, Eli Lilly & Co. and Abbott Laboratories offered new hires 17 and 15 vacation days, respectively, while rival Merck & Co. kept the standard 10. Merck is now finding that college grads actually care. "We're looking at enhancing vacation because as re-

contributions, a standard employee perk, and supersized it to \$10,000. Other companies are ramping up programs that let employees contribute more time to volunteer work. Consulting firms such as Bain and Accenture allow employees to take subsidized sabbaticals to consult for nonprofits, and No. 23-ranked Wells Fargo & Co. allows employees to teach at local schools during the regular workday

## There's a premium on vacation days. "Even at entry level, [candidates] are asking: 'What time off am I getting?'"

cruiters we're seeing some challenges," says Merck's director of university relations, Regina P. Flynn. "Even at entry-level they're asking: 'What time off am I getting?'" No. 2-ranked Lockheed Martin allows some employees who work nine-hour days to take every other Friday off and gives others broad latitude to make their own hours. Michael Van Gelder, a 27-year-old team leader on a multimillion-dollar government project who joined Lockheed five years ago, says that's a big deal: "I'm not responsible to punch in and punch out. I feel I'm responsible for a job, not a shift."

## Young Idealism

OFTEN UNABLE TO offer competitive wages, nonprofits such as Teach for America Inc., No. 43, and federal agencies such as the CIA, which came in at No. 32, may nevertheless have certain pluses over for-profit companies in the bidding for young talent. Government jobs frequently have reasonable hours and solid benefits, and along with nonprofits they offer an outlet for youthful idealism, which is particularly strong among the Millennials, as it was among those who came of age during the 1960s. In the University survey, 27% of undergraduates now list contributing to society as a top career goal; the survey added the option this year after hundreds of students penciled it in. That's good news for both federal agencies, where 44% of civil servants will become eligible for retirement in the next five years, and the nonprofit sector, where employment growth is outstripping that at for-profit companies.

Private-sector employers, too, are picking up on the importance of providing new hires with a way to give back to society. Goldman, for example, recently took the \$2,000 company match on charitable

without docking their pay.

How, on the other hand, do companies like No. 29 Philip Morris USA appeal to a socially aware generation? Clearly any employer in a business that damages health or the environment will be a hard sell, but high-profile targets like tobacco companies are particularly so. Philip Morris, however, has an innovative recruiting pitch that promotes the opportunity to develop technologies that make cigarettes less harmful. CEO Michael Szymanczyk says the campaign touches a nerve with certain recruits: "People who are interested in challenges, interested in solving tough problems, find this to be an attractive place to work because it's got plenty." It doesn't hurt that nearly 1 out of 5 entry-level employees earns more than \$55,000 a year, far more than any other consumer-goods company in the ranking.

Having an opportunity to make a big impact can clinch the deal for young grads. At No. 21 Pepsi Bottling Group Inc., especially promising new hires who go through the company's training program can find themselves managing a team of employees within six months to a year, vs. the two to three years it typically takes elsewhere. And at Google, all employees are encouraged to spend one full day a week developing or working on a new idea of their own choosing. Google's penchant for putting young employees in the driver's seat is legendary. Salar Kamangar, who joined after graduating from Stanford University in 1999, five years before the company went public, wrote Google's first business plan and led the engineering team that launched AdWords, its proprietary method for tailoring Web ads to search terms (page 68). It's safe to say that without Kamangar, Google wouldn't be Google.

While Kamangar was a self-starter, a

**DETERMINING WHICH EMPLOYERS** are best for entry-level workers is no easy task. To find *BusinessWeek* used a three-part method.

First, we surveyed career services directing leading U.S. colleges to learn which employers topped their list. We then asked those em-

| EMPLOYER IN |                                                                |
|-------------|----------------------------------------------------------------|
| 2006 RANK   | EMPLOYER/INDUSTRY <sup>1</sup>                                 |
| 1           | <b>Walt Disney</b> <sup>4</sup><br>ENTERTAINMENT               |
| 2           | <b>Lockheed Martin</b><br>MANUFACTURING                        |
| 3           | <b>Deloitte &amp; Touche</b> <sup>5</sup><br>ACCOUNTING        |
| 4           | <b>Goldman Sachs</b><br>FINANCIAL SERVICES                     |
| 5           | <b>Enterprise Rent-A-Car</b><br>TRANSPORTATION                 |
| 6           | <b>State Dept.</b><br>GOVERNMENT                               |
| 7           | <b>Raytheon</b><br>MANUFACTURING                               |
| 8           | <b>General Electric</b><br>MANUFACTURING                       |
| 9           | <b>JPMorgan</b> <sup>6</sup><br>FINANCIAL SERVICES             |
| 10          | <b>Abbott Labs</b><br>PHARMACEUTICALS                          |
| 11          | <b>Verizon</b><br>TELECOMMUNICATIONS                           |
| 12          | <b>Ernst &amp; Young</b><br>ACCOUNTING                         |
| 13          | <b>Google</b><br>TECHNOLOGY                                    |
| 14          | <b>National Instruments</b><br>TECHNOLOGY                      |
| 15          | <b>KPMG</b><br>ACCOUNTING                                      |
| 16          | <b>L'Oréal</b><br>CONSUMER GOODS                               |
| 17          | <b>Bain &amp; Co.</b><br>CONSULTING                            |
| 18          | <b>Merck</b><br>PHARMACEUTICALS                                |
| 19          | <b>Ameriprise Financial</b> <sup>7</sup><br>FINANCIAL SERVICES |
| 20          | <b>Accenture</b><br>CONSULTING                                 |
| 21          | <b>Pepsi Bottling</b><br>CONSUMER GOODS                        |
| 22          | <b>Lehman Brothers</b><br>FINANCIAL SERVICES                   |
| 23          | <b>Wells Fargo</b><br>FINANCIAL SERVICES                       |
| 24          | <b>United Parcel Service</b><br>TRANSPORTATION                 |
| 25          | <b>Vanguard</b><br>FINANCIAL SERVICES                          |

te a survey seeking information on pay, benefits, and training programs, ve then compared with others in the industry. Finally, we obtained from um Communications, a Philadelphia h firm, the results of its 2006 survey of

37,000 U.S. undergraduates, who were asked to identify their five most desirable employers.

The employer survey counts for 50% of the final ranking, while the career services and student surveys count for 25% each.

For the complete rankings, go to

[www.businessweek.com/bsschools](http://www.businessweek.com/bsschools), where you'll be able to find an interactive version of this table and profiles of all 55 employers.

| RANKING MEASURES |                            |                            |                                   |                                        | QUALITY MEASURES              |                                                |                                                                                                                                           |
|------------------|----------------------------|----------------------------|-----------------------------------|----------------------------------------|-------------------------------|------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------|
| EE<br>RY-<br>ES  | MOST<br>DESIRABLE<br>TRAIT | EMPLOYER<br>SURVEY<br>RANK | CAREER<br>SERVICES<br>SURVEY RANK | STUDENT<br>SURVEY<br>RANK <sup>2</sup> | AVERAGE<br>PAY<br>(THOUSANDS) | MANAGEMENT<br>TRAINING<br>PROGRAM <sup>3</sup> | COMMENTS                                                                                                                                  |
|                  | Communication skills       | 5                          | 36                                | 1                                      | NA                            | No                                             | Disney rose to No. 1 on its reputation with students. Cynics need not apply: Culture stresses creativity, optimism, and decency.          |
| ing              | College major              | 4                          | 5                                 | 5                                      | \$50 to \$55                  | Yes                                            | Offers leadership programs in communications, engineering, finance, human resources, information systems, and operations.                 |
| ss               | Communication skills       | 21                         | 2                                 | 7                                      | \$50 to \$55                  | Yes                                            | One out of four partners has 20+ years with the firm. One-third of experienced hires are boomers who have left and returned.              |
| ss               | College GPA                | 9                          | 4                                 | 7                                      | \$55 and above                | Yes                                            | Goldman alums include Treasury Secretary Henry M. Paulson Jr., NYSE Chairman John Thain, and <i>Mad Money</i> host Jim Cramer.            |
| ss               | Work experience            | 24                         | 1                                 | 36                                     | Less than \$35                | Yes                                            | Management training program amounts to an MBA crash course for executive wannabes. New hires get to run their own businesses.             |
|                  | Judgment <sup>11</sup>     | 11                         | 19                                | 3                                      | \$45-\$50                     | Yes                                            | Training to be a Foreign Service officer takes entry-level hires from classrooms to simulated jail cells to their first foreign postings. |
| ing              | College major              | 1                          | 27                                | 19                                     | \$55 and above                | Yes                                            | Once you're in, you're in—43% of top executives have been with the company 20 years or more.                                              |
| ing              | College major              | 17                         | 7                                 | 9                                      | \$50 to \$55                  | Yes                                            | Entry-level hires in the training programs get to experience GE's legendary Crotonville (NY) training facility.                           |
| rts              | NA                         | 13                         | 8                                 | 11                                     | \$55 and above                | Yes                                            | A new partnership with Teach for America allows grads to complete both programs back to back.                                             |
|                  | Leadership skill           | 7                          | 12                                | 16                                     | \$50 to \$55                  | Yes                                            | Company offers on-site fitness centers at many U.S. locations and a sports and activities program.                                        |
|                  | Leadership skills          | 2                          | 33                                | 27                                     | \$35 to \$40                  | Yes                                            | Verizon Wireless recently launched a retail training program where participants work in as many as three locations over two years.        |
| ss               | College major              | 31                         | 3                                 | 5                                      | \$50 to \$55                  | No                                             | In 2005, E&Y instituted a permanent four-day weekend for Labor Day, July 4th, and Memorial Day.                                           |
| ing              | NA                         | 27                         | 20                                | 2                                      | NA                            | NA                                             | Free gourmet lunches, an on-site masseuse, and the freedom to spend one day a week on your own project. What's not to love?               |
| ing              | College major              | 3                          | 16                                | 41                                     | \$50 to \$55                  | Yes                                            | NI puts its money where its mouth is, spending over \$30,000 a year to train each participant in its engineering Leadership Program.      |
| ss               | College major              | 23                         | 6                                 | 12                                     | \$45 to \$50                  | Yes                                            | Its allotment of 25 paid days off for entry-level professionals is one of the most generous of all the companies in the ranking.          |
| ss               | Leadership skills          | 10                         | 41                                | 10                                     | \$50 to \$55                  | Yes                                            | Rising entry-level marketing stars are put through a fast-paced training program that lasts between 18 months and two years.              |
| rts              | Analytical skills          | 6                          | 20                                | 23                                     | \$55 and above                | Yes                                            | Bain is on a hiring binge. Entry-level hiring is up more than 20% over 2005's total—and the year's only half over.                        |
| rts              | College major              | 7                          | 41                                | 13                                     | \$50 to \$55                  | Yes                                            | Every entry-level hire who goes through the management training program gets a permanent position.                                        |
|                  | NA                         | 16                         | 16                                | 17                                     | \$35 to \$40                  | Yes                                            | This American Express spin-off increased entry-level hiring from 799 in 2004 to 992 in 2005.                                              |
| ss               | Analytical skills          | 20                         | 10                                | 20                                     | \$50 to \$55                  | No                                             | Tired of the grind? Accenture lets employees take sabbaticals at half pay to do consulting work for nonprofits.                           |
| ss               | Work ethic                 | 12                         | 39                                | 14                                     | \$45 to \$50                  | Yes                                            | This could be you: Seven top executives launched their own careers in Pepsi's entry-level training program.                               |
| rts              | Leadership skills          | 14                         | 25                                | 23                                     | \$55 and above                | Yes                                            | The financial services giant gives entry-level hires something to look forward to—employees own about 30% of company shares.              |
| ss               | Analytical skills          | 22                         | 9                                 | 27                                     | \$55 and above                | Yes                                            | Management training participants meet at San Francisco headquarters for two days that include meetings with senior execs.                 |
| ss               | Leadership skills          | 18                         | 16                                | 27                                     | \$50 to \$55                  | Yes                                            | Part-timers at UPS receive comprehensive medical benefits just like full-time employees.                                                  |
|                  | Communication skills       | 15                         | 39                                | 32                                     | NA                            | Yes                                            | Four extensive rotational training and development programs range from 12 to 24 months in length with three to six rotations.             |



common criticism of Millennials is that they tend to require a lot of hand-holding by managers. Having grown up in the cocoon of parental attention and positive feedback, they expect much of the same from their employers, including frequent evaluations and mentoring. That's not always easy. Shan Cooper, Lockheed's vice-president for diversity and equal opportunity programs, men-

organized sports and other team activities from before their first day of kindergarten. Even in school, solitary assignments have gradually given way to team projects. The result: a generation that feels most comfortable pursuing well-defined goals as part of a team. In the world of work, such a preference can be an asset. But as employees move into leadership roles, where goals are not always

**"I encourage my employers, even if they think they're giving [Millennials] a lot of feedback, to double it," says an adviser**

tors five Lockheed employees and says newcomers want to be evaluated "weekly, daily, hourly." Cam Marston, founder of Marston Communications in Charlotte, N.C., who advises companies on how to manage Millennials, says Cooper has it right: "I encourage my employers, even if they think they're giving a lot of feedback, to double it."

For the first time in U.S. history, four generations co-exist in the workforce, with many employees working well into their golden years. And that's leading to a rising level of intergenerational tension. Employers are finding their newest hires may be blurring the lines between boss and friend. Says Marston: "There's a difference between getting a drink with your boss and being your boss's drinking buddy. The Millennials are trying to cross that line a little bit."

One aspect of the Millennial mindset that worries some academics and executives is the generational preference for teams. Many of them, and to a lesser extent Gen Xers, grew up on a steady diet of

well-defined and success frequently requires a bold leap into the unknown, independent thinking and risk-taking could suffer. Every generation develops leaders, of course, but this one could have a harder time than most. Says Andrea S. Hershatter, director of Emory University's Goizueta Business School undergraduate program: "It is going to be an interesting challenge for them to become creative, autonomous professionals."

It's easy to overgeneralize about a generation, and as critics of such armchair psychology point out, it often means extrapolating too broadly from the experience of upper-middle-class suburban youth. But these are largely the young men and women who will fill the management tracks of U.S. companies and, in doing so, transform the American workplace. By the time the last of them walk onto the job in 2022, their predecessors will have already ushered in a new age of work that bears only a superficial resemblance to the one the boomers and Gen X left behind. ■

## Preparing to Launch

A sampling of what's available at [www.businessweek.com](http://www.businessweek.com):

**Tools:** Create your own personalized ranking with our interactive table.

**Stats:** In-depth profiles of all 55 ranked employers.

**Tips:** Advice on how to avoid job hunt flubs and first-year rookie mistakes.

**Video View:** A roundtable with recruiters from three top companies.

**Slide Show:** See where some top CEOs got their starts, and the lessons they learned.

**Also:** Check out Executive Editor John A. Byrne's podcast interview with Staff Editor Lindsey Gerdes about the ranking.

**BusinessWeek Weekend:** Why some top Wall Street firms think college athletes make stronger job candidates. Check your local TV listings, or visit [businessweekweekend.com](http://businessweekweekend.com).

**BusinessWeek online**

[businessweek.com/extras](http://businessweek.com/extras)

MEL LINSTROM

EMPLOYER INFO

| 2006 RANK | EMPLOYER/INDUSTRY <sup>1</sup>                    | ENT |
|-----------|---------------------------------------------------|-----|
| 26        | <b>AT&amp;T</b><br>TELECOMMUNICATIONS             |     |
| 27        | <b>Eli Lilly</b><br>PHARMACEUTICALS               |     |
| 28        | <b>MTV Networks</b> <sup>8</sup><br>ENTERTAINMENT |     |
| 29        | <b>Philip Morris</b><br>CONSUMER GOODS            |     |
| 30        | <b>Ferguson Enterprises</b><br>MANUFACTURING      | 1   |
| 31        | <b>BP America</b><br>ENERGY                       |     |
| 32        | <b>CIA</b><br>GOVERNMENT                          |     |
| 33        | <b>Federated</b> <sup>9</sup><br>CONSUMER GOODS   |     |
| 34        | <b>Grant Thornton</b><br>ACCOUNTING               |     |
| 35        | <b>SunTrust Banks</b><br>FINANCIAL SERVICES       |     |
| 36        | <b>Shell Oil</b><br>ENERGY                        |     |
| 37        | <b>Progressive</b><br>FINANCIAL SERVICES          |     |
| 38        | <b>Peace Corps</b><br>nonprofit                   |     |
| 39        | <b>IRS</b><br>GOVERNMENT                          |     |
| 40        | <b>Booz Allen Hamilton</b><br>CONSULTING          |     |
| 41        | <b>NASA</b><br>GOVERNMENT                         |     |
| 42        | <b>Capgemini</b><br>CONSULTING                    |     |
| 43        | <b>Teach For America</b><br>NONPROFIT             |     |
| 44        | <b>Kraft Foods</b><br>CONSUMER GOODS              |     |
| 45        | <b>Northwestern Mutual</b><br>FINANCIAL SERVICES  |     |
| 46        | <b>Southwest Airlines</b><br>TRANSPORTATION       |     |
| 47        | <b>Kohl's</b><br>CONSUMER GOODS                   |     |
| 48        | <b>Comptroller of the Currency</b><br>GOVERNMENT  |     |
| 49        | <b>Exelon</b><br>ENERGY                           |     |
| 50        | <b>Progress Energy</b><br>ENERGY                  |     |



| ENTRY-LEVEL HIRING | RANKING MEASURES       |                      |                             |                                  | QUALITY MEASURES        |                                          | COMMENTS                                                                                                                             |
|--------------------|------------------------|----------------------|-----------------------------|----------------------------------|-------------------------|------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------|
|                    | MOST DESIRABLE TRAIT   | EMPLOYER SURVEY RANK | CAREER SERVICES SURVEY RANK | STUDENT SURVEY RANK <sup>2</sup> | AVERAGE PAY (THOUSANDS) | MANAGEMENT TRAINING PROGRAM <sup>3</sup> |                                                                                                                                      |
| ts                 | College major          | 19                   | 32                          | 30                               | NA                      | Yes                                      | Some salaried workers are eligible for overtime, and health-care benefits—for employees, not dependents—are free.                    |
|                    | College GPA            | 25                   | 25                          | 18                               | \$55 and above          | No                                       | Entry-level hiring was down 33% in 2005, but Lilly pays better than any of the other Big Pharma companies in the ranking.            |
|                    | NA                     | 26                   | 41                          | 38                               | NA                      | NA                                       | Internships are key to getting a foot in the door at MTV, which also includes channels like Comedy Central and Nickelodeon.          |
|                    | Leadership skills      | 28                   | 20                          | 30                               | \$50-\$55               | No                                       | The nation's largest tobacco company aims to overcome its PR challenge with generous perks.                                          |
| s                  | Work ethic             | 32                   | 14                          | 36                               | \$35 to \$40            | Yes                                      | Ferguson offers the ultimate in flexibility: The wholesale distributor of plumbing supplies has facilities in every state.           |
| ng                 | College major          | 30                   | 41                          | 26                               | \$50 to \$55            | No                                       | New entry-level hires get an experienced mentor plus a buddy to help them adapt to their new work environment.                       |
|                    | College major          | 46                   | 27                          | 4                                | NA                      | No                                       | The government agency recruits prospective employees as early as high school with its Undergraduate Scholarship Program.             |
| s                  | Analytical skills      | 35                   | 11                          | 34                               | \$35 to \$40            | Yes                                      | The parent company of Macy's and Bloomingdale's has an extensive careers site featuring jobs in corporate and retail.                |
| s                  | Leadership skills      | 29                   | 41                          | 38                               | \$45 to \$50            | Yes                                      | More than four out of five interns become full-time associates at Grant Thornton, the only non-Big Four accounting firm on our list. |
| s                  | Analytical skills      | 34                   | 20                          | 41                               | \$45 to \$50            | Yes                                      | As part of their training, many entry-level hires participate in a simulation that requires preparing a deal from start to finish.   |
| ng                 | Leadership skills      | 37                   | 20                          | 20                               | \$55 and above          | Yes                                      | Shell now uses its renewable energy initiatives as a recruiting tool with new college grads.                                         |
| s                  | Communication skills   | 33                   | 30                          | 41                               | \$35 to \$40            | No                                       | Nearly three out of four employees are 40 or younger, and women outnumber men 54% to 46%.                                            |
| ts                 | NA                     | 41                   | 12                          | 41                               | Less than \$35          | Yes                                      | Offers returning volunteers job placement assistance and \$6,000 to aid in making the transition.                                    |
| s                  | College major          | 39                   | 36                          | 20                               | \$35 to \$40            | No                                       | The federal agency that everyone loves to hate has one of the best three- and five-year retention rates around.                      |
|                    | References             | 40                   | 30                          | 32                               | \$40 to \$45            | No                                       | Do volunteer work and the company will make a volunteer service grant to the organization.                                           |
|                    | College major          | 36                   | 41                          | 35                               | \$45 to \$50            | NA                                       | You may not get to fly the Space Shuttle, but the entry-level jobs are among the highest-paid for federal agencies in our ranking.   |
| and ng             | Analytical skills      | 38                   | 36                          | 38                               | \$55 and above          | No                                       | Company is guided by seven core values that include boldness, freedom, and fun.                                                      |
| ts                 | Leadership skills      | 44                   | 15                          | 41                               | \$35 to \$40            | NA                                       | Its army of nearly 4,400 teachers will reach nearly 375,000 students this year. It hopes to double in size by 2010.                  |
|                    | College major          | 43                   | 41                          | 23                               | \$45 to \$50            | No                                       | The maker of Miracle Whip, Jell-O, and A1 Steak Sauce offers in-house fitness centers and dry cleaning for employees.                |
| s                  | Entrepreneurial spirit | 42                   | 27                          | 41                               | \$40 to \$45            | Yes                                      | As independent contractors paid on commission, entry-level hires can soar. The top 10 earners averaged \$86,000 in 2005.             |
|                    | Fun-loving attitude    | 45                   | 35                          | 15                               | Less than \$35          | No                                       | The airline's can-do culture and free flights are a draw for entry-level hires.                                                      |
|                    | Leadership skills      | 47                   | 33                          | 41                               | \$40 to \$45            | No                                       | Kohl's, one of the fastest-growing retailers in America, is probably in a suburb near you.                                           |
| s                  | College major          | 48                   | NA                          | NA                               | \$40 to \$45            | Yes                                      | Flextime policy allows employees to take every second Friday off by working nine-hour days.                                          |
| ng                 | College GPA            | 49                   | NA                          | NA                               | \$50 to \$55            | Yes                                      | This regional energy company, with operations in the Midwest, Mid-Atlantic, and Texas, boasts a strong commitment to diversity.      |
| ng                 | Analytical skills      | 50                   | NA                          | NA                               | \$35 to \$40            | No                                       | For some positions, a pre-employment test is required if you want to work for this southern energy supplier.                         |

are self-reported by employers. (1) Comparison group for employer survey. (2) Data provided by Unversum Communications. (3) Only training programs lasting one year or more, including analyst programs at JPMorgan Investment Bank, Lehman Brothers, and SunTrust Banks. (4) Career services survey rank also reflects respondents who identified ESPN as a top employer for entry-level hires. (5) Career services survey reflects respondents who identified Deloitte Consulting as a top employer for entry-level hires. (6) Investment bank only; however career services survey rank reflects respondents who identified JPMorgan Chase as a top entry-level hires. (7) Student survey data are for American Express, which spun off Ameriprise in October 2005. No student survey data are available for Ameriprise. (8) Student survey data are for the parent company. Student survey data are available for MTV Networks. (9) Career services survey rank reflects respondents who also identified Macy's as a top employer for entry-level hires. (10) Includes only Foreign Service Officer, Police Specialist, and Civil Service hires. (11) For Foreign Service Officer candidates only. (12) Independent contractors affiliated with branch offices.

ssWeek, Unversum Communications Inc. Research by Lindsey Gerdes, Louis Lavelle, Frederick F. Jespersen, Sophia Asare, Romy Drucker, Paula Lehman, and John DeBrucker





# GET READY FOR A PICKIER WORKFORCE

Today's teens say employers without a social conscience need not apply

BY LINDSEY GERDES

**T**EN YEARS AGO, A DECENT salary offer and the prospect of advancement were all an employer needed to entice new college grads. Today it helps to be in a sexy industry like media

or technology and be open to flextime and job-sharing. But when the next wave of job seekers starts looking for work in 2010, watch out. New research suggests that these savvy young people will look deep inside companies to see what makes them tick—and find many sorely wanting.

That could make recruiting the workforce of tomorrow a challenge. Now 14 to 18 years old, these teens say they are committed to equality, prefer companies that act responsibly, and care deeply about a clean environment. For some, civic-minded activities may be resumé-padding, and for others, youthful idealism may fade. But if these values largely survive this cohort's adolescence, experts say, the decisions they make, from the sneakers they

buy to the companies they'll work for, will likely be guided by such views. One study by Energy BBDO, a Chicago ad agency affiliated with BBDO Worldwide, concluded that to succeed with this group, brands can't just strive to stand out, they "must strive to stand for something."

Many of the differences between these kids and college grads now entering the workforce can be traced to September 11. Many twentysomething job seekers, coming of age during the late 1990s dot-com boom, grew up feeling entitled and came to expect gravity-defying pay and promotions. Those who are following them are living in an era of orange alerts, terror plots, and war.

With such turmoil, experts say, comes a search for meaning in work. "I think the 9/11 experience changed a lot of things," says Stan Moor, who

teaches philosophy to teens from his summer philanthropy class at the Westminister Schools, a private institution in Atlanta. "Students seem to have a 'fight for a cause' type of attitude." Young people say life's too short to waste on a job that only pays the bills. "If I find my passion for something, I'll go for it," says Jordan Peterson, a 15-year-old in Seymour, Ind.

## NEW RECRUITING STRATEGIES

THE GOAL FOR companies will be to convince this younger generation that they're one of the good guys. In the Energy BBDO study, which surveyed 3,000 teens worldwide, 78% said money was less important to them than personal fulfillment. Some are already acting on their convictions. James Sebel, 17, a budding environmentalist who took Moor's class, says he's drawn to companies like outdoor apparel maker Patagonia, which contributes 1% of sales to environmental causes. Says Sebel: "I like to shop at places where they have a similar opinion about things that I do."

Where will Sebel and his generation find satisfying work? Experts say that teens, who are highly attuned to personal values, will seek employers they perceive as being part of a larger social purpose. If good bet, they say, would be companies like Whole Foods Market Inc., the Austin, Tex.-based natural foods chain with an egalitarian pay structure that caps executive pay at 14 times that of the typical worker.

While today's teens are years away from the job market, companies are already finding ways to attract and retain their future employees. Some, such as consultant Accenture,

pay employees to volunteer with nonprofits. Others take a personal approach. When Laura Bradner, 23, joined Abbott Laboratories last year, two relatives had diabetes and she leaped at the chance to do diabetes research. "I'm involved in launching a few projects," she says. "It's really interesting."

Such strategies, promising, may be straining at the breaking point as companies are scrambling to recruit replacements for the millions of retiring boomers. After all, few companies are in the business of saving the world, and there are or many openings for hero

**78**  
Percentage of teens who say money is less important than personal fulfillment

Data: Energy BBDO survey of 3,332 teens worldwide

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THE NEW VALUE FRONTIER





# Wireless Takes Wing



With infrastructure improvements, users will be able to send data faster from more places than ever before.

**Y**ou may have missed this intriguing milestone of the computer industry: Just over a year ago—in August 2005—for the first time, retail sales of laptops exceeded desktop sales. If those new laptop users are looking for wireless access, the United States currently has 120,107 Wi-Fi hotspots. The number of cell phones, as of last year: almost 200 million.

The trend is clear for business: “Companies are using wireless technology to improve productivity, so that users can work wherever and whenever,” says Russell Senesac, InfraStruXure Systems Manager at American Power Conversion (<http://www.apcc.com/>), a manufacturer of devices for infrastructure reliability.

New technologies are only going to make it easier—though as with most technology, there will be a period of confusion. Vendors will scatter new wireless technologies in the marketplace and customers will have to figure out which works best for them. This confusion stems from the simple fact that, up until now, there have been essentially two kinds of networks: one for voice and one for data.

Voice networks are optimized for transmitting voice. They can transmit data, using equipment from network vendors, but not as well as data networks. Conversely, data networks using IP—the Internet’s data-oriented communications protocol—can now transmit voice conversations; but again, not as well as they transmit data. Not surprising, according to research firm In-Stat, the device of choice for wireless data access is laptop and notebook computers (see chart).

## THE CHANGING WIRELESS INFRASTRUCTURE

Among the new technologies, falling under the rubric of broadband wireless, two are most important for business users: WiMax, theoretically standing for maximum wireless, and EV-DO, which stands for evolution of data optimization. The big brother of Wi-Fi, WiMax enables data transmission within a range of 30 miles, as opposed to 300 feet in a wireless local-area network. WiMax is also the big brother when it comes to speed: 70 megabits per second (Mbps), compared with 54 Mbps for the latest version of the Wi-Fi standard and 3.1 Mbps for the latest version of EV-DO.

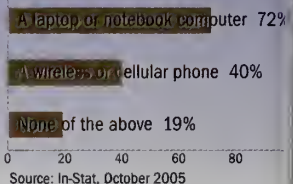
What applications will the new technologies mean for business users? “Computing will become more personalized,” says Robert Syputa, a senior analyst at wireless research firm Maravedis. Key applications for wireless will relate to either delivering information based on a user’s location or delivering more information faster. “If you can save a sales service technician who’s looking up information 20 minutes, that equates money,” Syputa says.

Corporations will get wireless connectivity one of two ways. They can order it from the telecom carriers, the way they currently get long distance. Jim Straight, vice president for data services at Verizon Wireless, says the company’s EV-DO applications and services will work with other 3G and 4G networks because they all use common open standards. Alternatively, corporations can deploy broadband wireless themselves for campus connectivity. The ideal: Users could roam anywhere on a corporate campus without losing their connection to the network.

If corporations do deploy broadband wireless themselves, it is important to remember that, as with a wired network, infrastructure reliability is key. “Speed is no longer the issue,” says APC’s Senesac. “Costs are coming down, and security is fairly stable. The bottleneck is network availability.” He recommends that if you’re deploying wireless routers and wireless access points in a building or a campus, think about equipping them with battery backup to ensure uptime.

## Devices Used for Wireless Data

(multiple answers allowed)



## ONE NETWORK FOR ALL?

Will there ever be just one network handling voice and data? Most experts agree that it’s not coming in the near future. Why? Because of the potential cost of upgrading to an infrastructure that will transmit both, not to mention the inherent challenge of creating a communications protocol that handles data and voice equally well—and as clearly as voice networks do now.

“The goal is to have a converged network that will handle voice and wireline seamlessly,” says Jagdish Rebello, director and principal analyst for wireless communications at research firm iSuppli. To do that, however, you’d need all communication providers to transition to a “grand” IP-based network—something Rebello doesn’t see happening for at least three to four years.

The possibility can’t be denied from a technological standpoint. We’ve come a long way from the lack of clarity on cellular networks. From an economic standpoint, though, it’s a different story.



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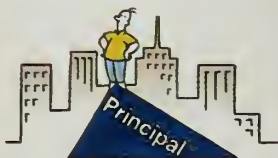
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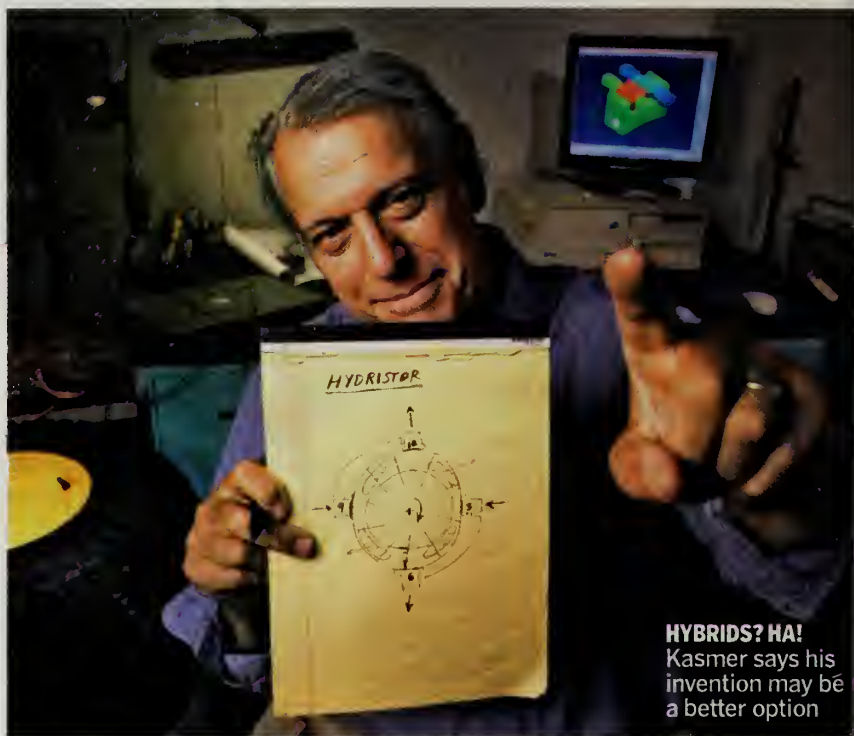
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## Science & Technology | Cars



**HYBRIDS? HA!**  
Kasmer says his invention may be a better option

# Gas Saver Or Tailpipe Dream?

A new kind of hybrid uses hydraulics instead of batteries to save fuel

BY DAVID WELCH

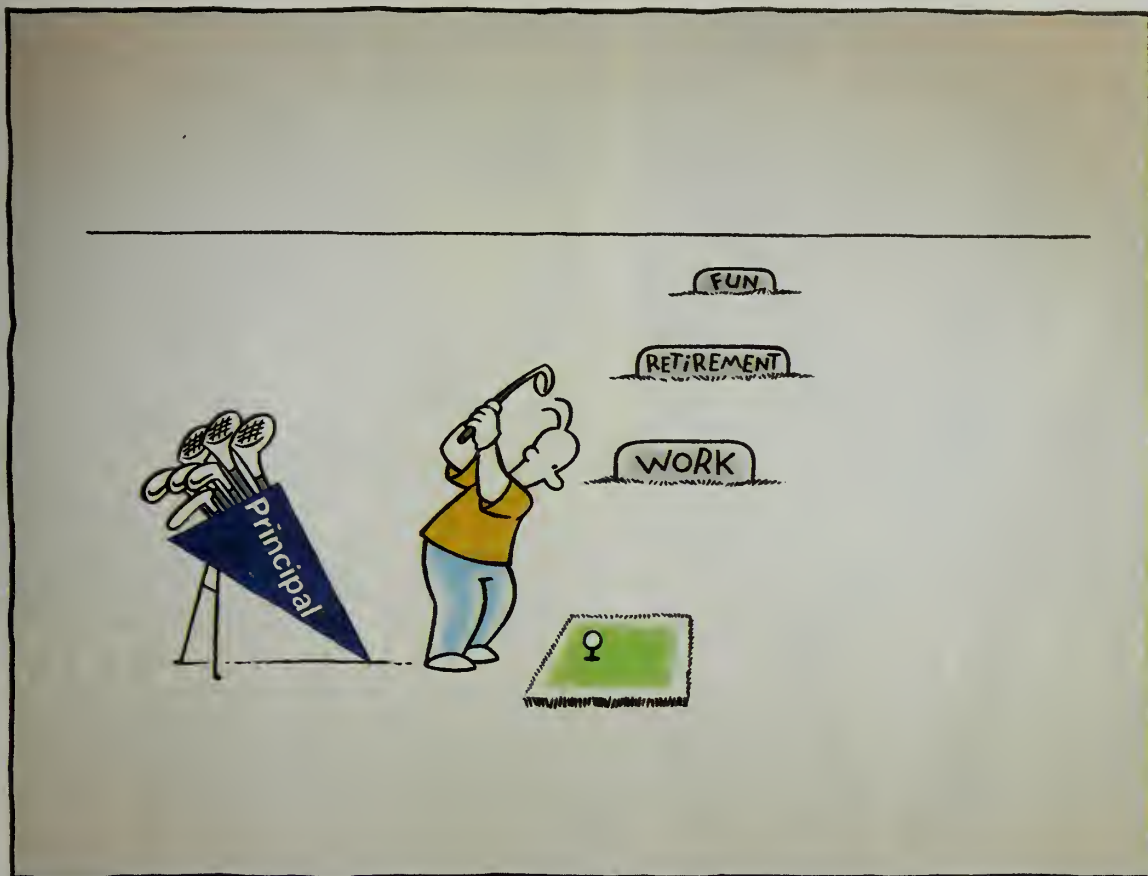
**T**HANKS TO HIGH FUEL prices, hybrid gasoline-electric vehicles such as the Toyota Prius are constantly in the limelight. But far away from that glow, government scientists, auto parts engineers, and garage inventors are toiling on a distinctly less glamorous way to save fuel. It's a hybrid vehicle that pairs a gas engine with a hydraulic transmission. You may associate hydraulics with ancient, oily gear lifting heavy loads on farms and construction sites. But like everything old, this is new again.

Whenever gas prices shoot up, inventors and tech companies come out of the woodwork, trumpeting the next mileage-boosting miracle. And certainly

there is room for fresh thinking, since savings on hybrids and clean-diesel vehicles can take four years or more to make up for the difference in cost to the buyer. Maybe that's why parts makers such as Eaton Corp. and BorgWarner Inc. are suddenly pushing hybrid hydraulic systems for everything from delivery trucks and garbage haulers to small cars and motorcycles. The sales pitch: The hydraulic approach is relatively inexpensive. "This could be a better option than the hybrids on the road today," says Kasmer.

Hydraulic hybrids have been ignored because they present big engineering challenges, noise being one. In 2004, Eaton and the Environmental Protection Agency teamed up with United Parcel Service to put hydraulic delivery

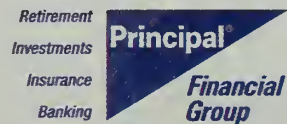
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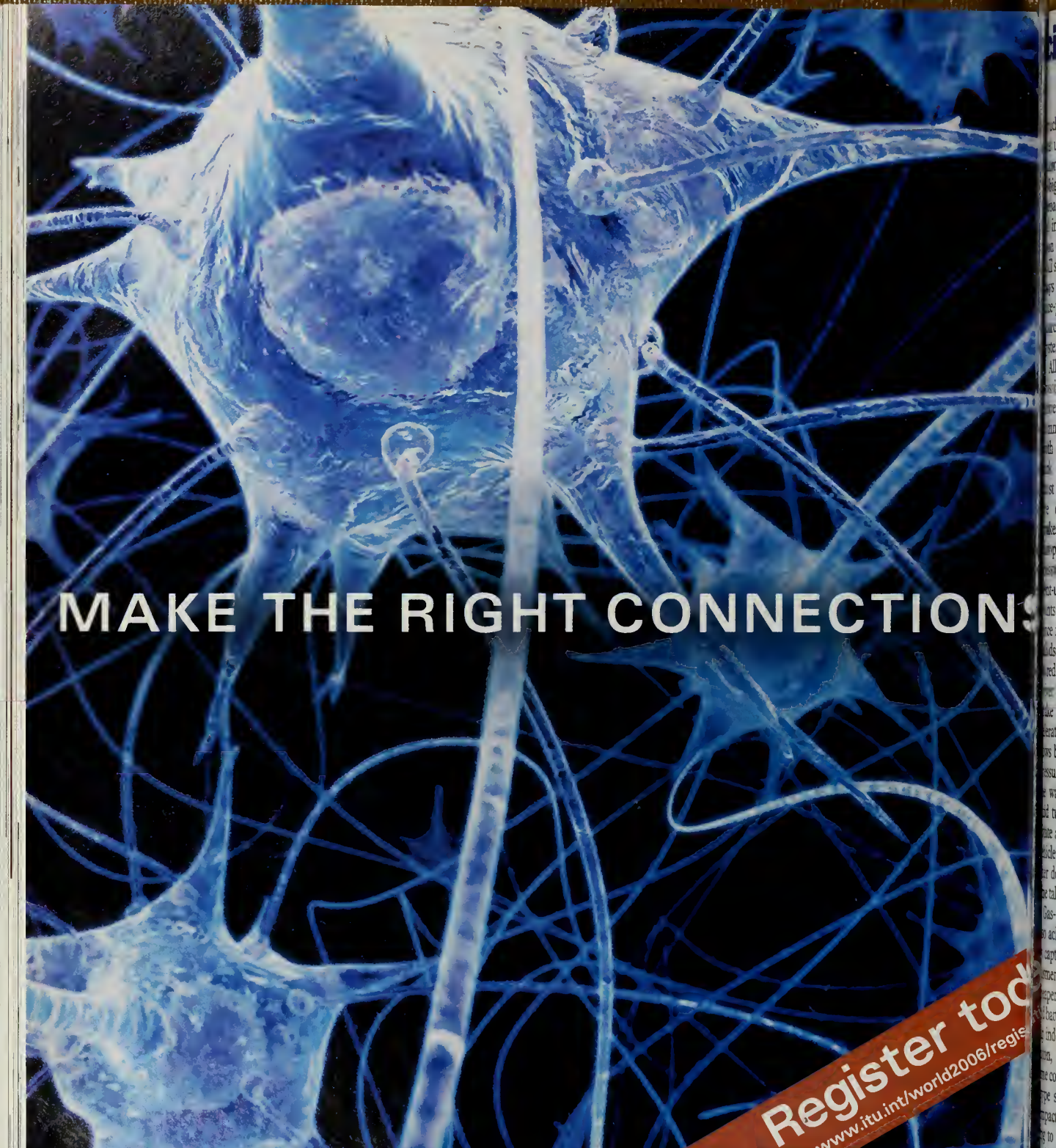


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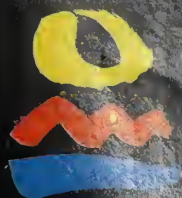
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ucks on the road. In tests, the prototypes et upwards of 50% better fuel economy. asmer himself has failed to connect with big carmaker so far, but his hybrid approach, known as a hydristor, has attracted interest from Bobcat Co., a construction equipment maker. "The technology will start with large commercial vehicles,"

ys Sohan Uppal, ce-president for research for Eaton's fluid systems group.

All hydraulic transmission systems have some basic features in common. They begin with a low-pressure tank filled with fluid, most often oil. When the driver hits the brakes, the liquid is pumped into a high-pressure tank. The pent-up fluid naturally wants to escape. But once it can't, pressure builds and energy is stored. Then, when the driver releases the brake and hits the accelerator, the liquid flows back to the low-pressure tank. Along the way, the rushing fluid turns vanes that rotate an axle, and the vehicle takes off. Only after does the gas engine take over.

Gas-electric hybrids also achieve efficiency

by capturing energy from braking. But Kasmer claims his hydristor would be cheaper than the computer controllers and batteries in Prius-like hybrids. Working independently of Kasmer, the EPA, Eaton, and BorgWarner reached the same conclusion. BorgWarner put a prototype system in a Chinese-made subcompact car, raising its mileage from 33 mpg to 40 in tests, says Bill Kelly, vice-president for drive train development.

## PEDAL POWER

IN TRUCKS, however, that the technology may really prove its value. Eaton's Uppal says the company has developed a system for garbage haulers that could reap terrific fuel savings because the vehicles could make up to nine stops in a row running on stored hydraulic power alone. EPA project manager John Kargul says that for a variety of trucks, the fuel savings from hydraulics could offset

higher sticker prices in less than three years—a tall order for today's pricier gas-electric hybrid designs.

Truly exotic applications may be at hand. Stymied in Detroit, Kasmer is working with a major bicycle maker that hopes to adapt his design to replace conventional chains and gears. Such a bike might prove easier to build and pedal because the hydristor would make seamless, gear-like adjustments as the rider pumped up and down hills.

Detroit's carmakers say that they have good reasons for keeping their distance. Thomas G. Stephens, group vice-president for power train operations at General Motors Corp., wrote in an e-mail that plenty of inventors have tinkered with hydraulics or related ideas. Yet he doesn't see how any could come close to doubling fuel economy, as Kasmer has claimed. And no matter how big their benefits, hydraulic systems are prone to leaks.

Then there's the noise issue. "[They] groan like the landing gear on an airplane," admits Kelly of Borg-

Warner. Considering their shaky financial situation, U.S. automakers aren't likely to spend the research money needed to iron out these kinks. They're even less likely to bet the \$1 billion it takes to scale up production of a new transmission, Kelly says.

Kasmer still dreams of getting his hydristors into passenger cars. But he has to work on his presentation. When he spoke to a group of engineers at Munro & Associates Inc., a Troy (Mich.) engineering consulting firm with clients such as DaimlerChrysler and Boeing Co., the demo impressed some of the engineers. But when they asked him for technical details, he balked at giving away design secrets. Instead, says Sandy Munro, principal of the firm and one of Kasmer's financial backers, Kasmer lectured listeners about cleaning up the air for tomorrow's children. The techies wanted more info, and when it wasn't forthcoming, a few headed for the door. ■

## Set to Roll

Hydraulic technology—the use of pressurized fluid to store energy—has been around for a long time. Soon it may find surprising new applications in transportation:

### CARS & TRUCKS

Eaton and the Energy Dept. have developed new UPS trucks that capture power during braking, then reuse it to put the wheels in motion before the engine is switched on.

### HEAVY EQUIPMENT

Companies like Bobcat may use a novel hydraulic device called a hydristor to make their heavy equipment cheaper. It would also make them more efficient.

### BICYCLES

Using tiny pistons and pressurized fluids, bikes could transfer the rider's energy from the pedals to the rear wheel, eliminating the need for greasy chains and gears.



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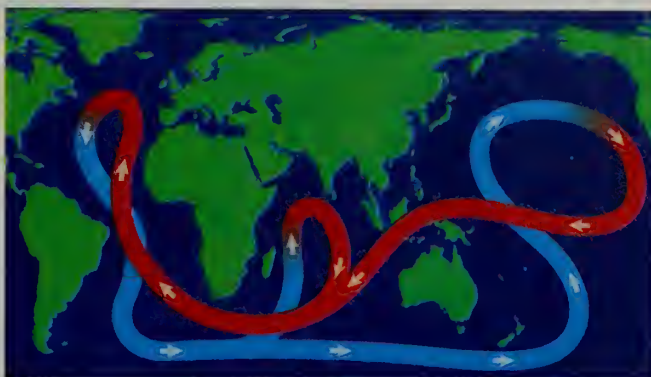
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## INNOVATIONS

Of towering trees  
and obese mice

► Purdue University researchers are tinkering with the DNA of a hybrid poplar tree in hopes of creating a new source of biofuel. Their vision: a tree that can shoot up 15 feet a year, and whose wood, when fermented, will yield nearly twice as much energy per bushel as corn kernels used to make ethanol today. Grown on fallow land, the sterile trees wouldn't compete with food crops and shouldn't accidentally trade genes with any other plants. The researchers' first focus is to lower the amount of a compound called lignin in the poplar's cells. Lignin gives trees strength but gums up the ethanol-making process.

► Excessive consumption of carbohydrates, which convert to fat in the body, is a leading cause of obesity. By suppressing the protein that controls this carbs-to-fat process, researchers have shown that they can prevent obesity and reduce appetite—at least in mice. Working with mice engineered to become obese, the scientists suppressed the gene that produces the suspect protein. The mice with the disabled gene remained thin, even though they ate a very high carbohydrate diet. They also consumed less food than mice that had the gene intact. And they were less likely to have symptoms of diabetes. University of Texas researcher Kosaku Uyeda says the protein, called ChREBP, could be a target for anti-obesity drugs. The research was funded by the National Institutes of Health and the Veteran's Administration.



## GLOBAL WARMING OCEAN CURRENTS: FLIPPING THE 'OFF' SWITCH

**SCIENTISTS** have predicted that global warming might flip a planetwide switch that controls ocean currents, triggering drastic climate shifts. In fact, this could happen over the next century, sooner than originally thought.

The switch involves the flow of cold, salty water in the North Atlantic and Arctic Oceans. As these relatively heavy waters sink, they drive a massive deep-ocean current that flows south and then east. To replace all that sinking water, warm water is drawn up from the tropics. But if the Arctic waters grow warmer and less

salty, eventually they will stop sinking, and this thermal conveyor belt will halt. One likely effect: Winters in Europe and parts of Canada and the U.S. will get colder.

This dramatic change was thought to be centuries off. But in an upcoming paper in *Science* researchers from the Marine Biological Laboratory in Woods Hole, Mass., and elsewhere calculate that rising precipitation and melting ice are flushing enough fresh water into the Arctic Ocean that the switch may be flipped by the year 2100. —John Carey

## MATERIAL GAINS YOUR NEXT LIGHT JACKET

**CLOTHES ARE ABOUT** to get a whole lot brighter. With Philips' new Lumalive system, swaths of fabric can be turned into glowing,



multicolored panels able to display characters or simple animations. The key is a web of tiny light-emitting diodes (LEDs) integrated into a layer of the fabric. Powered by a small battery pack and connected by superfine wires, Lumalive materials are so light they drape just like normal fabric. Expect to see larger grids of the illuminated textiles replacing regular fabrics in everything from upholstery to draperies to wall coverings. Although Philips isn't yet talking about price, commercial production is slated for 2007. And with it, inevitably, comes the dawn of animated jacket-back ads.

## AUTOMATION THESE ROBOTS WON'T ROCK BUT WILL ROLL

**BREAKTHROUGHS** in robot locomotion don't come often. One has just rolled out of Carnegie Mellon University, a hotbed of robot innovation. The new bot scoots about on a rubber ball the size of a cantaloupe—a design that makes CMU's "ballbot" highly maneuverable.

The robot, which stands about five feet tall, relies on three gyroscopes and a high center of gravity to stay upright. Its computer brain interprets readings from the gyros, then balances and steers by means of small electric rollers atop the ball. The rollers can propel it in any direction, and also keep the ballbot's lighter lower half centered under its heavier upper half, explains Ralph Hollis, a research professor at CMU's Robotics Institute.

The top-heavy design has advantages over conventional robots. For one, its base is much smaller than those relying on legs, wheels, or tractors, so the 95-lb. unit can get into tighter spaces and can rotate in place. That's important, as researchers believe such automatons will one day work in homes and offices. The ballbot has one flaw, though. So far, it works only on flat surfaces. Hollis says his team's next test is to attach mechanical arms to the unit to see how they affect its movement.

—Michael Arndt





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**A. Exchange business cards**



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ANMA  
COUNTRY CLUB,  
SHANGHAI

Why an international  
membership could be  
good for your business

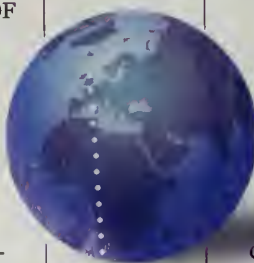


# Global MEMBERS

» Belonging to a club overseas is a lot easier and less expensive than you might think. By Tom Harack

THE INITIATION FEE AT CRUDEN BAY IS A BARGAIN COMPARED WITH FEES IN U.S. CLUBS

IN THE EARLY 1990s, JOE ONSTOTT LEARNED OF an opportunity to join Tralee Golf Club, which sits on a bay in the southwest of Ireland. At the time few private golf clubs offered international memberships, and Onstott, who had played there on his first trip to the country, decided he couldn't pass it up. He doesn't regret it. Since joining, he's played numerous club events, including the international members' championship each September, and he's solidified business relationships.



Cruden Bay, Scotland

"I've met many interesting people from all over the world, and I've also been able to treat them to a special golf experience," says Onstott. He owns an executive search firm near Boston. His son, a 1-handicap college golfer and novice member, has visited Tralee several times. It's not hard to understand the appeal. Saydon Dagleish, co-founder of PerryGolf, an Atlanta-based golf-tour operator: "For Americans, clubs in the British Isles offer a combination of instant tra-





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**SAN ROQUE  
(ABOVE)  
RESTS IN THE  
HEART OF  
ANDALUCIA  
IN SPAIN**



**San Roque,  
Spain**

exotic golf terrain, and bragging rights back home.”

Adds David Baum, publisher and editor-in-chief of *Golf Odyssey*, a golf-travel newsletter: “Given how expensive the high-end clubs are at home...international clubs look surprisingly affordable. For the price of joining Liberty National across the Hudson River from lower Manhattan [\$400,000 initiation, \$20,000 annual dues], one can join a half-dozen international clubs and still have money left over for first-class airfare.”

The appeal makes just as much sense from the clubs’ standpoint, says Heidi Voss, president of Bauer Voss Consulting, which specializes in private-club memberships: “These members typically spend much more per visit than the average local member. So while the initiation fees and dues are generally low, out-of-town and overseas members are more of an ongoing revenue generator. And because they are usually members of other clubs, they bring prestige to the club.”

The popularity of international memberships has prompted many permutations of initiation fees, procedures, dues, and privileges. Ireland and Scotland remain the most fertile ground for such programs, but the principles have been embraced worldwide, and many clubs are conceived specifically to cultivate absentee members. How do you wade through the numerous options? Start by learning about different clubs you have in mind on the Web, contact the membership director about requirements, and arrange a visit. The successful equation requires

a sober appraisal of your priorities, including:

- **CAN’T GET THERE FROM HERE.** What seems exotic during the first commute can become tedious. Be realistic about how often you’ll use your membership.
- **BUSINESS OR PLEASURE?** Many clubs allow overseas members a generous number of rounds. But there are often restrictions on guest play, so pay heed to a club’s limits if you plan to use it for business entertaining.
- **HIDDEN COSTS.** It might be impossible to calculate them all, but some clubs, for example, require you stay on-site whenever you visit.

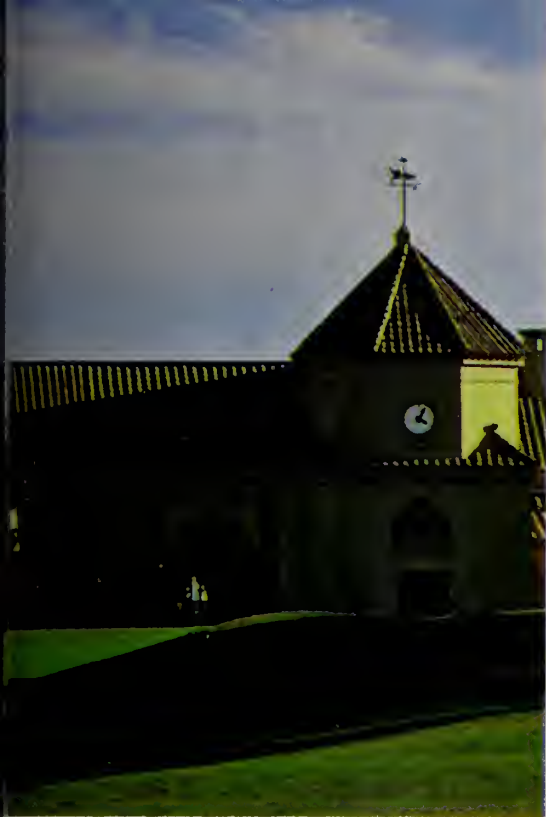
- **GOLF GAME OR LIFESTYLE?** Events and concierge services are integral to the selling points—and pricing—of many memberships. How important are nongolf aspects of a club’s surroundings?

- **TRADITIONAL OR CONTEMPORARY?** One golfing tradition is another’s stuffy anachronism, says Sam Baker, founder and CEO of Cincinnati-based Havasham & Baker Golfing Expeditions. “The easier a club is to get into, the more it’s likely to cost,” he says. A club with a pedigree is important to some; others prefer to get in on the ground floor and consider a lack of a rigorous approval process a plus.

Here’s a quick trip around the world to sample some of the clubs offering international memberships:

**T**HE SAN ROQUE Club, Cadiz, Andalusia, Spain ([sanroqueclub.com](http://sanroqueclub.com)).

Membership provides preferential rates to nearby Valderrama and Sotogrande. The club



part of a resort, has 36 holes, the old 18 by Dave Tommas, the new layout by Perry Dye.

**BASIC FEES:** \$28,120 with limited rounds during the year and \$1,915 annual dues.

**PROS:** Although overbuilding threatens the area, nearby attractions include Marbella and its beaches, Ronda (the home of sherry), Ronda, Gibraltar, as well as the incomparable Alhambra, the ancient citadel of Moorish kings near Granada.

**CONS:** The usual itinerary from the U.S. includes a connection in Madrid, a flight to Malaga, and more than an hour's drive, making for a long travel day.

**D**OONBEG GOLF Club, County Clare, Ireland ([doonbeggolfclub.com](http://doonbeggolfclub.com)).

A club that caters to an international membership, Doonbeg creates a sort of "instantaneous heritage." Its lodge, opened in the spring of 2006, is designed to look like a medieval castle, in keeping with the spa and the rest of the complex.

Its Greg Norman-designed course runs along the Atlantic and could pass for a century-old links even though it was completed in 2002. Doonbeg is a commercial endeavor, complete with residential real estate, not a club in the member-administered sense.

**BASIC FEES:** A one-time \$60,000 refundable initiation; \$1,555 a year for individual, \$1,955 family.

**PROS:** It's about a 45-minute drive from Shannon Airport. For residents of the East Coast, the

DOONBEG  
(ABOVE,  
RIGHT) LIES  
ON IRELAND'S  
WEST COAST,  
SOUTH OF  
LAHINCH



Doonbeg,  
Ireland

plane ride takes about as long as a flight to California. With Ballybunion and Lahinch as neighbors, you are at the nexus of Irish links golf.

**CONS:** No matter how astute management's rendering of an ancient golf atmosphere, it can't be re-created in a matter of months or years. About two-thirds of the 400 members signed up thus far are Americans.

**C**RUDEN BAY Golf Club, Aberdeenshire, Scotland ([crudenbaygolfclub.co.uk](http://crudenbaygolfclub.co.uk)).

If your devotion to the game includes its history, a place like Cruden Bay is for you. The original course was designed by Old Tom Morris and opened in 1899, but it is said that golf was played in the village a century before that.

**BASIC FEES:** Annually, \$500 (men), \$470 (women). Initiation fee is the same as the annual fee.

**PROS:** As a member pointed out, at these rates you can view your membership as a contribution to the game. When you do play, it's on one of the classics.

**CONS:** Even if you don't combine a visit to Cruden Bay with a stop at St. Andrews, this is a long trip. The club is a three-hour drive north from Edinburgh.

**T**IANMA COUNTRY Club, Shanghai, China ([tianma.cc](http://tianma.cc)).

China increasingly is becoming an attractive golf destination. With 27 holes by Pacific Coast Design, an Australian firm, this is the sort of addition





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**BASIC FEES:** \$14,209 nonrefundable fee, application fee, \$600 annual dues.

**PROS:** The resort, at which international members get hefty discounts, makes a great base of operations for the wealth of activities available to guests.

**CONS:** Apart from the dateline-traversing commute, the voucher-regulated guest-admission policies seem a bit arcane, a point worth considering if copious entertaining is part of your plan.

to the scene that will proliferate: immaculate conditions, dramatic settings, tons of amenities such as a full-service spa, fine dining, and recreation activities. With a booming economy, the Chinese will skip the egalitarian aspects of the game's evolution and proceed directly to the golf-as-business phase.

**BASIC FEES:** \$77,500 individual initiation, \$1,600 annual dues; \$102,500 family and corporate initiation, \$2,400 annual dues.

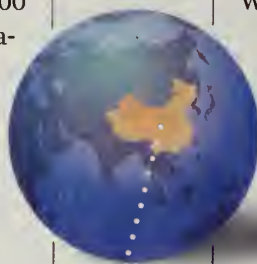
**PROS:** Businessmen with dealings in Shanghai and golfers craving the unusual will revel here.

**CONS:** Even though China is becoming a more familiar golf destination, a club closer to home may be more appealing.

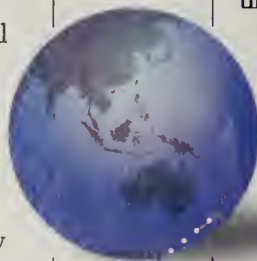
**M**ILLBROOK COUNTRY Club, Queenstown, New Zealand ([millbrook.co.nz](http://millbrook.co.nz)).

Membership in this club was until recently confined to property owners of the nearby residential real estate. Now there are a limited number of nonresidential memberships. The valley, framed by a mountain range named the Remarkables, where you can ski in summer, is emblematic of the country's immense natural beauty and topographical variety, and nearby Queenstown is a combination of quaint and chic.

CHINA'S  
TIANMA  
(ABOVE).  
NEW  
ZEALAND'S  
MILLBROOK  
(RIGHT)



Tianma,  
China



Millbrook,  
New Zealand

All the variables involved in evaluating international memberships could result in a problem common in golf: paralysis by analysis. Michael W. Sweeney's experience might prove ameliorative. "I joined Enniscrone Golf Club in Ireland a few years ago on a whim," he recalls. Sweeney, a partner and investment analyst at Waterville Investment Research in New York. From

home from Nebraska, he met a father and son who had had a great time at Sand Hills Golf Club. So he decided to create that type of "retreat atmosphere" for his son, who is now 10. With the name Sweeney, Ireland was an obvious choice, but he did not want to wait on a list at Ballyliffin, Royal Portrush, or Lahinch. "Playing with the locals at Enniscrone is fun," he says, "especially when they have competitions every Sunday." And the time \$2,000 fee at Enniscrone epitomized "the love of the Irish" for Sweeney. The fee is now \$5,110.

The trick is to find that same kind of opportunity today.

*Tom Harack is a writer/photographer specializing in golf destinations.*

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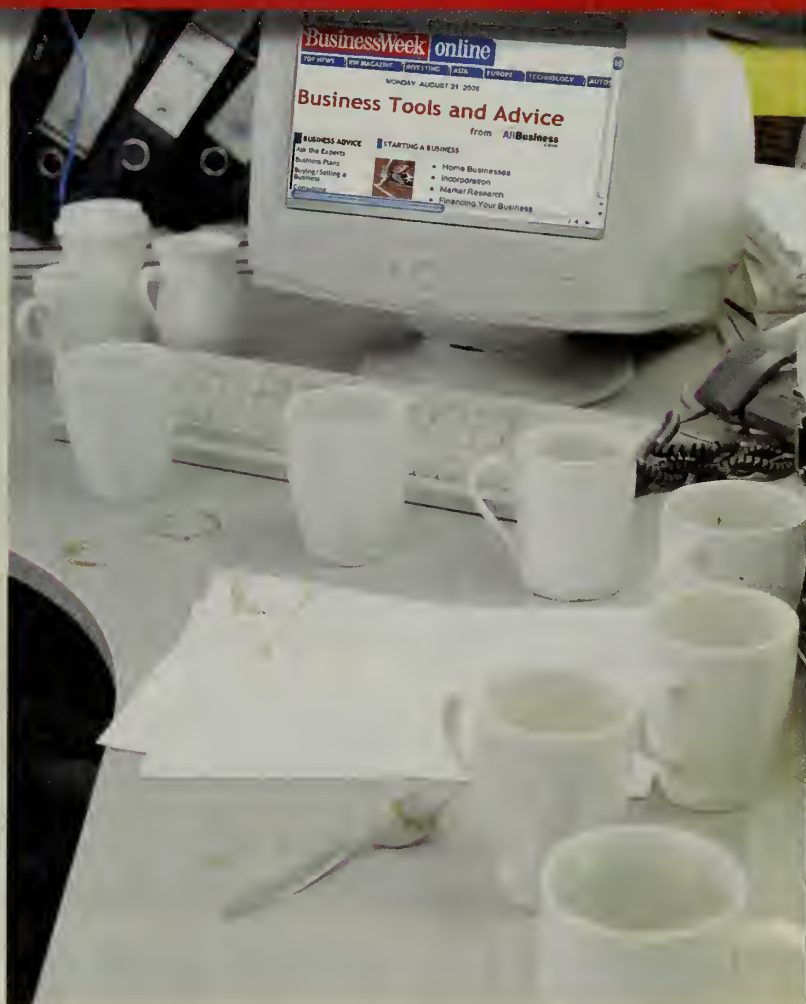
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# Preservation Inse

Hankering to live in an historic property? Federal and state incentives can help.

**T**HE HOUSE, AN IMPOSING 77-YEAR-OLD stone structure with arched entryways, had not aged well. Its beautiful vaulted ceilings and crown moldings were encased in countless layers of paint. Asbestos lurked in every nook and cranny. The appliances dated back decades. It desperately needed a loving owner to restore it to glory. Enter Tracy Bacigalupo, a partner in the international law firm DLA Piper US in Baltimore. Three years ago she paid \$675,000 for the 6,000-square-foot, 10-room fixer-upper, and she has been making it over from top to bottom ever since.

By the time she's finished later this year, Bacigalupo will have sunk about \$500,000 into the restoration. But not all of that will come out of her pocket. Because the house is in Baltimore's historic

Homeland neighborhood, designed in 1924 by famed landscape architect Frederick Law Olmsted, the state of Maryland is helping her out. Bacigalupo has received one tax credit of \$50,000 and ex-

pects to get another \$50,000 credit from a state program that encourages people to rehabilitate historic properties.

If you have a weakness for old homes, you, too, may be eligible for state or federal preservation incentives. Tax credits are only one option. Some homeowners can get a federal income tax write-off if they take steps to ensure no changes will ever be made to the property that is incompatible with its historic character.

Maryland is one of more than a dozen states offering tax credits, including New York, which passed a new law this year. For a list, visit the National Trust for Historic Preservation's website, [nationaltrust.org/funding](http://nationaltrust.org/funding). To





et

S. BY ELLEN HOFFMAN

l incentives are available, check with  
r county or municipality.

# MP UP THE VALUE

3 FEDS also offer assistance for in-  
ne-producing properties—not  
idences. There's a tax credit  
20% of the cost of rehab-  
g a government-certified  
oric property, or 10% for  
structure built before  
6. Cris Reynolds, a  
sician in Edenton,  
, is claiming about  
4,000 in federal and  
e credits over five years  
r spending \$385,000 to  
ion an office out of a de-



crepit 1907 Colonial Revival-style house he bought in 2004 for \$2,000. Among the improvements he made—after moving the house half a block to the historic main street of town—were repairing the ravages of water damage, closing up holes in the walls, and replacing a rusted metal roof.

Tristan O'Connell, a Baltimore tax attorney, figured out a way to live in the house and still take advantage of federal largesse. He arranged for his parents to create a limited liability company (LLC) to buy and fix up an 1892 home in the city's Federal Hill district. His parents recouped 40% of the rehab costs of \$180,000 from federal and state tax credits. In the meantime, O'Connell moved in and paid a market rent of \$1,400 a month. Complying with federal law, he purchased the house from the LLC five years later.

If you buy a historic home for, say, \$100,000 and turn it into one worth a million, you're primed for a big property tax hit. To soften the blow, some states offer abatements. Georgia freezes real

**DETAILS** Original artwork adorns some of the interior doors

## FORMER GLORY

Bacigalupo (facing page) will spend about \$500,000 to restore her 1920s home, which features intricate tilework (left) and French doors (below). She's expecting tax credits of \$100,000

estate taxes for eight years on historic properties that have increased at least 50% in value. The regular tax rate phases back in over the next two years.

The other strategy for defraying the cost is donating a property "easement" to a nonprofit historic trust in return for a federal income tax deduction. The easement ensures that the owner, and future owners, won't change the exterior without the trust's permission. Joseph Nacmias, a CPA who rehabilitated a 1912 town house in the Brooklyn (N.Y.) neighborhood of Park Slope, says he'll reap

\$80,000 to \$100,000 in charitable deductions for donating the easement to the facade to the National Architectural Trust in Washington. It's one of hundreds of organizations created for this purpose.

Nacmias, working with an architect, had to get approval of his renovation plans from both the Park Slope Historic District and the New York City Landmarks Preservation Commission. There are other restrictions if you donate an easement, and they just got stricter. In response to publicity about abuses, President George W. Bush on Aug. 17 signed a law that tightens requirements for valuing a property; strengthens the definition of a "qualified appraiser," who certifies the property value; and limits your charitable deduction if you're also claiming the federal rehabilitation tax credits.

Most people who fix up an historic property will tell you they do it for personal satisfaction and to preserve our architectural heritage. Basil Whiting, a community development consultant who renovated his historic home in Brooklyn, is a good example: For donating the facade of his house to a preservation group, he's getting a charitable deduction of some \$40,000. What will he do with the money? Spend it on the last rehab project waiting to be done: restoring the facade. ■





BY ROBERT PARKER

# Bordeaux: Estates That Beat 2003's Heat

Châteaux with humble pedigrees can surprise you in a year of heat and drought, especially if they have moisture-retentive soil better-known estates lack. That certainly is the case with the 2003 vintage in Bordeaux. Following are some terrific, intensely concentrated wines from the vintage. They prove that not all Bordeaux wines are incredibly expensive. They're all between \$14 and \$25 a bottle.

## Gigault Cuvée Viva 2003 (Premières Côtes de Blaye)

**90 points.** Stéphane Derenoncourt is the winemaking consultant behind what could be among the greatest values of the vintage. Full-bodied and opulent with oodles of black cherry and cassis fruit, smoked herbs, sweet licorice, and charcoal notes, this stunningly proportioned wine must be tasted to be believed. It should age beautifully for four to six years, but who can resist it now? \$14

## Cambon La Pelouse 2003 (Haut-Médoc)

**87 points.** It comes from a huge southern Médoc estate that is part of the high-quality Haut-Médoc group of châteaux called Biturica. The wine offers chocolate, toasty oak, and black cherry characteristics in its medium-bodied, deep, modern, up-front, appealing style. Drink it over the next five to six years. \$16

## Belle-Vue 2003 (Haut-Médoc)

**88 points.** An excellent choice for those seeking fairly priced, high-quality classic Bordeaux. This nearly 25-acre vineyard is planted with an unusually high percentage of petit verdot (20%) along with 50% cabernet sauvignon and 30% merlot. A strong success, the 2003 offers a fragrant bouquet of black cherry jam, cedar, and toasty vanilla, a beautiful texture, and considerable persistence on the palate. The final blend included 27% petit verdot, which is a remarkably high amount for a Bordeaux wine. Perhaps that extra petit verdot explains the freshness in this



wine from the southern Médoc. Enjoy over the next seven to eight years. \$19

## Brisson 2003 (Côtes de Castillon)

**87 points.** A sleeper of the vintage, this delicious, uncomplicated, corpulent wine is dominated by merlot. It offers plenty of mocha, black cherry, and herb-like characteristics, as well as a big, plush entry, a silky texture, and an elegant, fleshy finish. Sip it over the next four to five years. \$20

## La Vieille Cure 2003 (Fronsac)

**92 points.** The best wine yet made at La Vieille Cure, which is becoming one of the finest

estates in Fronsac. It's a must-buy for seekers of tremendous quality at a great price. Its deep ruby/purple color is followed by sweet aromas of scorched earth, black raspberries, crème de cassis, and notions of cherries, smoke, and crushed rocks. This big, full-bodied, captivating wine is both structured and exceptionally long. Anticipated maturity: 2007 to 2018+. \$23

## D'Escurac 2003 (Médoc)

**89 points.** The wine is much better than its pedigree would suggest. It reveals a deep ruby/purple color as well as a bouquet of burning embers, black currants, cherries, and licorice. Medium-bodied, gorgeously fruity, lushly textured, well-balanced, and with a long finish, it will provide lovely drinking over the next five to six years. \$23

## Tour Haut-Caussan 2003 (Médoc)

**90 points.** This wine exhibits a dense ruby/purple color with notes of incense, tobacco, smoke, cedar, and black currants. Spicy, medium-bodied, and moderately tannic, it will last over the next 5 to 10 years. \$25

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BY GENE G. MARCIAL

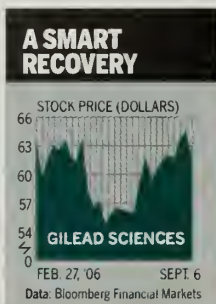
**DOMINANCE IN ANTI-HIV DRUGS IS DRIVING UP GILEAD SCIENCES**

**AFTER A SUMMER TUMBLE, BURGER KING IS LEANER THAN USUAL**

**MEDIS IS SET TO CHARGE BILLIONS OF CELL PHONES AND IPODS.**

## Gilead Has 'Room to Run'

**M**OST PHARMACEUTICAL COMPANIES are limping, but Gilead Sciences (GILD) has sprinted from 53 to 61.54 this year. "Gilead's dominance in anti-HIV drugs continues to drive the stock," says Hans Danielsson of AIG Global Investment Group, which owns Gilead shares. At 23 times the consensus 2007 earnings estimate of \$2.63 a share, the stock is cheap, says Danielsson, and it has room to run. Better-than-expected second-quarter results showed that Gilead's "exciting products continue to widen its lead in that huge market," he adds. The Food & Drug Administration has approved several of Gilead's anti-HIV drugs, including Atripla, a stand-alone, once-a-day treatment launched in July. Jennifer Chao of Deutsche Bank expects Atripla sales to rise from \$135 million in 2006 to \$2.2 billion in 2008. Chao, who rates Gilead a "buy," expects it to earn \$2.43 a share on sales of \$2.98 billion this year and \$2.87 on \$3.8 billion in 2007, up from 2005's \$1.66 on \$2 billion. Gilead's second-quarter anti-HIV drug sales of \$475 million were above analysts' forecasts and 28% up from sales a year ago. Cameron Lavey of Standard & Poor's rates the stock a "buy" and says it deserves a premium rating because of its "predictable growth and dominant position" in the HIV market. He expects Gilead's earnings to increase by an average of 19% a year through 2010. His 12-month target for the stock: 72.



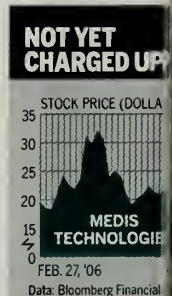
## Now, Burger King Looks More Appetizing

**B**URGER KING HOLDINGS (BKC) leaped out of the frying pan into the fire in early August when it reported disappointing results for its fourth quarter ended June 30. The stock, which tumbled 10%, to 13, on Aug. 2, has since inched up to 14.62. Linda Killian, portfolio manager at IPO Plus Fund, which owns shares, says the sell-off makes the world's No. 2 hamburger chain "even more attractive." Killian, who is also a principal at Renaissance Capital, which advises the IPO Fund, says this is because Burger King has the management and skilled personnel to fire up the company and boost sales and earnings. John Ivankoe of JPMorgan Securities has reiterated his rating of "overweight" on Burger

King, which went public at 17 on May 17, and he agrees that the stock's fall is a "compelling value opportunity for long-term investors." He says the company's turnaround and strong cash flow are "intact." He figures Burger King will earn \$1 a share in the year ending June 30, 2007, and \$1.17 in fiscal 2008, up from 86¢ in 2006.

## Juiced About Medis Technologies

**A**LTHOUGH MEDIS TECHNOLOGIES (MDTL) expects to start shipping its disposable fuel-cell "Power Pack" products by yearend, skeptics abound on the stock now trading at 18.76. Some pros have sold short 7 million shares, equal to about 70% of the stock's free float. But Gary Giblen of broker Brean Murray Carret rates Medis a "strong buy" and has raised his profit forecasts from 50¢ to 54¢ a share for 2007 and from \$1.50 to \$1.60 for 2008. Product of the Power Packs for recharging electronic products, such as cell phones and iPods, is "running smoothly" at Medis' plant in Tel Aviv, says Giblen. That "makes [us] comfortable modeling slightly lower cost of goods" and higher profits, he adds. Arthur Gray of investment bank Carret, which owns Brean Murray and holds Medis shares, says the stock could hit 100 by 2008. Another bull, Otis Bradley of Gifford Securities, says the power needs of cell phones alone, which he estimates at 2 billion units, are escalating. The fuel cell, developed by Israeli Aircraft Industries in the 1960s for use in space and submarines, is being tested by major mobile-phone outfits. Israeli Aircraft has licensed the patented technology to Medis and owns 5.3 million of Medis' 36 million shares outstanding, or 15%. Chairman and CEO Robert Lifton controls 9.5 million, Merrill Lynch EnergyFund 2.4 million and the Lester Crown family 2.3 million. ■



**BusinessWeek online** Gene Marcial's Inside Wall Street is posted at [businessweek.com/investor](http://businessweek.com/investor) at 5 p.m. EST on the magazine's publication day, usually Thursdays.

**Note:** Unless otherwise noted, neither the sources cited in Inside Wall Street nor the author hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.





### Here comes hope.

The first civilian helicopter rescue took place in 1945 off the coast of Connecticut.

$$FM = \frac{C_T^{3/2}}{\sqrt{2C_Q}} \quad (\text{Hover efficiency ratio})$$

Tail pylon

Composite tail blade

### HUMS (Health & Usage Management System).

This system monitors the S-92 continuously, enabling it to operate at peak performance. Think of it as a helicopter with a health plan.

Engine

Auxiliary power unit

Composite rotor blade

### Passing the hat.

Igor Sikorsky always wore a fedora. Marine pilots would visit him, believing that if they donned his hat it would protect them from harm. Today his helicopter does exactly that.

viser.

is one of the oldest companies in existence.

Float

scues per gallon.

most challenging weather ns, the S-92 can go 250 miles, search for two and return to base with pare. This is not even g in-flight refueling, also available.

emperature control

irect Maintenance Costs).

has up to 40% lower direct nce costs per flight hour than dium-lift helicopters.

ers or steps

ed for more e maintenance. ough thing

Retractable landing gear

Life raft

Side-mounted fuel tanks

Thermal imaging system

### Hooked for life.

Every part is built with unmatched precision to ensure the safety of our pilots and passengers.

### "Over here!"

There's thermal imaging available that allows rescuers to find people they can't see.

### X2 Technology.™

Stay tuned for this new technology, which will enable us to fly later this year at 250 knots, 60% faster than today's helicopters.

9 seats or 19 seats or 23 seats; whatever suits you.

### Ambidextrous.

There are almost no right or left-hand parts. Essentially all are universal for ease of replacement and reduced inventories.

or as long as it's green.

ircraft paint with low to zero VOCs (volatile compounds) protects the environment and employees.

## YOU DON'T HAVE TO UNDERSTAND EVERYTHING WE DO TO PROFIT FROM IT.

er it's our helicopters that saved 44,179 people from disaster sites last year or our fuel hat will lessen dependency on oil tomorrow, it's United Technologies at work. Where ould passion, precision, and cool stuff come together like this? To see other incredible of United Technologies, go to [utc.com/curious](http://utc.com/curious).



**United Technologies**

You can see everything from here.



## STOCKS

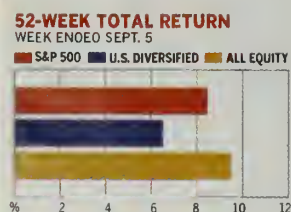
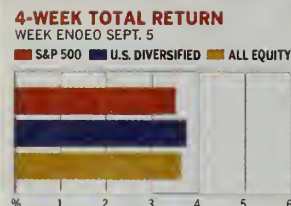


### COMMENTARY

After a week of solid gains, stocks retreated on Sept 6 on renewed inflation and interest rate jitters. Even as crude oil prices fell to a five-month low, news that labor costs had escalated faster than economists' estimates put the fear of further Fed rate hikes back in the market. Stocks saw their biggest losses since mid-July. Tech stocks led the decline.

Data: Bloomberg Financial Markets, Reuters

## MUTUAL FUNDS



Data: Standard & Poor's

## U.S. MARKETS

|                       | SEPT. 6  | WEEK | % CHANGE YEAR TO DATE | % CHANGE LAST 12 MONTHS |
|-----------------------|----------|------|-----------------------|-------------------------|
| S&P 500               | 1300.3   | -0.3 | 4.2                   | 5.4                     |
| Dow Jones Industrials | 11,406.2 | 0.2  | 6.4                   | 7.7                     |
| NASDAQ Composite      | 2167.8   | -0.8 | -1.7                  | 0.0                     |
| S&P MidCap 400        | 743.6    | -0.4 | 0.8                   | 4.0                     |
| S&P SmallCap 600      | 365.2    | -1.0 | 4.1                   | 4.1                     |
| DJ Wilshire 5000      | 13,000.5 | -0.3 | 4.0                   | 5.5                     |

## SECTORS

|                      |       | WEEK | % CHANGE YEAR TO DATE | % CHANGE LAST 12 MONTHS |
|----------------------|-------|------|-----------------------|-------------------------|
| BusinessWeek 50*     | 728.9 | -1.0 | -1.7                  | -1.8                    |
| BW Info Tech 100**   | 389.9 | -0.5 | 2.5                   | 5.6                     |
| S&P/Citigroup Growth | 603.2 | -0.5 | 1.1                   | 2.1                     |
| S&P/Citigroup Value  | 695.0 | -0.1 | 7.3                   | 8.9                     |
| S&P Energy           | 419.3 | -1.7 | 12.5                  | 8.4                     |
| S&P Financials       | 448.4 | 0.3  | 5.2                   | 12.5                    |
| S&P REIT             | 180.5 | -0.1 | 18.0                  | 14.9                    |
| S&P Transportation   | 241.9 | -0.1 | -3.2                  | 12.3                    |
| S&P Utilities        | 172.8 | -0.4 | 8.3                   | 2.7                     |
| GSTI Internet        | 170.8 | -1.2 | -16.8                 | -3.2                    |
| PSE Technology       | 798.4 | -1.0 | -4.5                  | -2.4                    |

\*Mar. 19, 1999=1000 \*\*Feb. 7, 2000=1000

## GLOBAL MARKETS

|                             | SEPT. 6  | WEEK | % CHANGE YEAR TO DATE |
|-----------------------------|----------|------|-----------------------|
| S&P Euro Plus (U.S. Dollar) | 1748.0   | -0.2 | 15.6                  |
| London (FT-SE 100)          | 5929.3   | 0.0  | 5.5                   |
| Paris (CAC 40)              | 5115.5   | -1.3 | 8.5                   |
| Frankfurt (DAX)             | 5813.1   | -0.9 | 7.5                   |
| Tokyo (NIKKEI 225)          | 16,284.1 | 2.6  | 1.1                   |
| Hong Kong (Hang Seng)       | 17,258.5 | -0.2 | 16.0                  |
| Toronto (S&P/TSX Composite) | 11,999.7 | -0.6 | 6.5                   |
| Mexico City (IPC)           | 20,965.2 | -1.7 | 17.8                  |

## FUNDAMENTALS

|                                      | SEPT. 5 | WEEK AGO |
|--------------------------------------|---------|----------|
| S&P 500 Dividend Yield               | 1.84%   | 1.84%    |
| S&P 500 P/E Ratio (Trailing 12 mos.) | 17.3    | 17.2     |
| S&P 500 P/E Ratio (Next 12 mos.)*    | 14.3    | 14.2     |
| First Call Earnings Revision*        | -1.21%  | -0.90%   |

\*First

## TECHNICAL INDICATORS

|                                       | SEPT. 5 | WEEK AGO |
|---------------------------------------|---------|----------|
| S&P 500 200-day average               | 1277.6  | 1276.1   |
| Stocks above 200-day average          | 57.0%   | 53.0%    |
| Options: Put/call ratio               | 0.86    | 0.90     |
| Insiders: Vickers NYSE Sell/buy ratio | 3.21    | 3.19     |

## BEST-PERFORMING GROUPS

|                         | LAST MONTH % |                          | LAST 12 MONTHS % |
|-------------------------|--------------|--------------------------|------------------|
| Tires & Rubber          | 18.3         | Agricultural Products    | 71.6             |
| Food Wholesalers        | 16.8         | Steel                    | 69.8             |
| Communication Equipment | 13.8         | Divsfd. Metals & Mining  | 66.6             |
| Internet Retailers      | 12.9         | Fertilizers & Ag. Chems. | 49.0             |
| Comptr. Stge. & Perphs. | 12.6         | Constr. & Engineering    | 35.5             |

## WORST-PERFORMING GROUPS

|                          | LAST MONTH % |                      | LAST 12 MONTHS % |
|--------------------------|--------------|----------------------|------------------|
| Oil & Gas Refining       | -17.8        | Homebuilding         |                  |
| Coal                     | -12.4        | Educational Services |                  |
| Real Estate Mgt. & Dvpt. | -11.6        | Internet Retailers   |                  |
| Auto Parts & Equip.      | -7.7         | IT Consulting        |                  |
| Constr. & Engineering    | -7.5         | Spclzd. Cnsmr. Serv. |                  |

## EQUITY FUND CATEGORIES

| 4-WEEK TOTAL RETURN  | %   | 52-WEEK TOTAL RETURN     | %    |
|----------------------|-----|--------------------------|------|
| <b>LEADERS</b>       |     | <b>LEADERS</b>           |      |
| Technology           | 9.1 | Precious Metals          | 69.6 |
| Communications       | 6.2 | Latin America            | 40.6 |
| Japan                | 5.4 | Diversified Emrg. Mkts.  | 29.4 |
| Small-cap Growth     | 5.0 | Diversified Pacific/Asia | 25.6 |
| <b>LAGGARDS</b>      |     | <b>LAGGARDS</b>          |      |
| Natural Resources    | 0.3 | Health                   | 1.9  |
| Miscellaneous        | 1.8 | Large-cap Growth         | 3.1  |
| Financial            | 2.0 | Technology               | 3.5  |
| International Hybrid | 2.0 | Small-cap Growth         | 4.5  |

## EQUITY FUNDS

| 4-WEEK TOTAL RETURN            | %     | 52-WEEK TOTAL RETURN       | %     |
|--------------------------------|-------|----------------------------|-------|
| <b>LEADERS</b>                 |       | <b>LEADERS</b>             |       |
| DireXn. NASDAQ 100 Bt 25X Inv. | 20.5  | Midas                      | 104.1 |
| ProFunds. Semicdr. Inv.        | 18.1  | U.S. Global Invsr. Gold    | 97.6  |
| Rydex Inv. Dynmc. OTC H        | 16.2  | U.S. Gbl. Invs. Prc. Mnl.  | 92.3  |
| ProFunds UltraOTC Inv.         | 16.0  | Van Eck Invsr. Gold A.     | 92.3  |
| <b>LAGGARDS</b>                |       | <b>LAGGARDS</b>            |       |
| DireXn. NASDAQ 100 Bt 25X Inv. | -17.4 | Ameritor Investment        | -81.8 |
| ProFunds UIKSh. OTC Inv.       | -14.0 | American Heritage Grth.    | -50.0 |
| Rydex Inv. Dynmc. OTC H        | -14.0 | ProFds. Mble. Tlcmms. Inv. | -23.3 |
| DireXn. Sm. Cap Br. 25X Inv.   | -13.1 | American Heritage          | -22.2 |

## INTEREST RATES

| KEY RATES                | SEPT. 6 | WEEK AGO |
|--------------------------|---------|----------|
| Money Market Funds       | 4.84%   | 4.85%    |
| 90-Day Treasury Bills    | 4.96    | 5.05     |
| 2-Year Treasury Notes    | 4.81    | 4.81     |
| 10-Year Treasury Notes   | 4.80    | 4.75     |
| 30-Year Treasury Bonds   | 4.95    | 4.91     |
| 30-Year Fixed Mortgage † | 6.20    | 6.25     |

†BancQu

## BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

|                       | 10-YR. BOND | 30-YR. BOND |
|-----------------------|-------------|-------------|
| General Obligations   | 3.87%       |             |
| Taxable Equivalent    | 5.53        |             |
| Insured Revenue Bonds | 3.93        |             |
| Taxable Equivalent    | 5.61        |             |

## THE WEEK AHEAD

**INTERNATIONAL TRADE** Tuesday, Sept. 12, 8:30 a.m. EDT » The foreign trade deficit is expected to have widened to \$65.5 billion in July, from \$64.8 billion in June. That's the median forecast of economists surveyed by Action Economics.

**RETAIL SALES** Thursday, Sept. 14, 8:30 a.m. EDT » August retail sales most likely rose 0.3%, after jumping 1.4% in July on stronger auto sales. Excluding

autos, August sales probably grew 0.5%, after a 1% increase in July.

**EXPORT-IMPORT PRICES** Thursday, Sept. 14, 8:30 a.m. EDT » Export prices likely climbed 0.3% in August. Import prices probably slipped 0.2%.

**BUSINESS INVENTORIES** Thursday, Sept. 14, 10 a.m. EDT » July inventories probably climbed 0.5%, after a 0.8% rise.

**CONSUMER PRICE INDEX** Friday, Sept. 15, 8:30 a.m. EDT »

Consumer prices for goods and services are forecast to have risen 0.3% in August, after a 0.4% rise in July. Less food and energy, the index probably increased 0.2% for a second straight month.

### INDUSTRIAL PRODUCTION

Friday, Sept. 15, 9:15 a.m. EDT » August factory output most likely expanded 0.2%, after improving by 0.4% in July. The factory utilization probably edged up to 82.5%, from 82.4%.

The BusinessWeek production rose to 284.1 for the week end 26, and stood 12.2% above the ago level. Before calculation four-week moving average, the rose to 283.9.

**BusinessWeek** on

For the BW50, more investment data, and the components of the production index visit [www.businessweek.com/extras](http://www.businessweek.com/extras)



# Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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How to benefit from dealer incentives designed to clear the way for 2007 models.

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Why top Wall Street firms are recruiting college athletes.

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What many companies are doing to hire and retain older employees.

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## The BusinessWeek Best-Seller List

| HARDCOVER BUSINESS BOOKS                                                                     |                                                                                                                                                                           |    | LAST MONTH                                                                             | MONTHS ON LIST | PAPERBACK BUSINESS BOOKS                                                                                                                                                           |                                                                                                           |  | LAST MONTH |
|----------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----|----------------------------------------------------------------------------------------|----------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|--|------------|
| 1                                                                                            | <b>THE WORLD IS FLAT</b> Thomas L. Friedman (Farrar, Straus & Giroux • \$30) <i>Globalization is great—sort of, says a columnist for The New York Times.</i>              | 1  | 15                                                                                     | 1              | <b>GOOD TO GREAT AND THE SOCIAL SECTORS</b> Jim Collins (Collins • \$11.95) <i>How noncorporate organizations can excel.</i>                                                       | 1                                                                                                         |  |            |
| 2                                                                                            | <b>FREAKONOMICS</b> Steven D. Levitt, Stephen J. Dubner (Morrow • \$25.95) <i>Crack gangs, the Ku Klux Klan, and more, examined by a University of Chicago economist.</i> | 2  | 16                                                                                     | 2              | <b>COLLAPSE</b> Jared Diamond (Penguin • \$17) <i>From Easter Island to Mayan Central America, why civilizations fall apart.</i>                                                   | 2                                                                                                         |  |            |
| 3                                                                                            | <b>BLINK</b> Malcolm Gladwell (Little, Brown • \$25.95) <i>Snap judgments deserve careful consideration.</i>                                                              | 3  | 19                                                                                     | 3              | <b>THE AUTOMATIC MILLIONAIRE</b> David Bach (Broadway • \$12.95) <i>Put your investment program on autopilot.</i>                                                                  | 5                                                                                                         |  |            |
| 4                                                                                            | <b>THE LONG TAIL</b> Chris Anderson (Hyperion • \$24.95) <i>How the mass market is giving way to a "mass of niches."</i>                                                  | —  | 1                                                                                      | 4              | <b>RICH WOMAN</b> Kim Kiyosaki (Rich Press • \$18.95) <i>How women can take control of their finances.</i>                                                                         | 4                                                                                                         |  |            |
| 5                                                                                            | <b>THE LITTLE RED BOOK OF SELLING</b> Jeffrey Gitomer (Bard Press • \$19.95) <i>A syndicated columnist's inspirational volume on why people buy.</i>                      | 5  | 23                                                                                     | 5              | <b>WHAT COLOR IS YOUR PARACHUTE?</b> Richard Nelson Bolles (Ten Speed Press • \$17.95) <i>The 2006 edition of the enduring job-search bible.</i>                                   | 3                                                                                                         |  |            |
| 6                                                                                            | <b>SECRETS OF THE MILLIONAIRE MIND</b> T. Harv Eker (HarperBusiness • \$19.95) <i>Shape your financial destiny.</i>                                                       | 6  | 16                                                                                     | 6              | <b>PAY IT DOWN</b> Jean Chatzky (Penguin • \$12.95) <i>The Today Show's financial editor on how to reduce your debts.</i>                                                          | —                                                                                                         |  |            |
| 7                                                                                            | <b>JIM CRAMER'S REAL MONEY</b> James J. Cramer (Simon & Schuster • \$26) <i>Trading tips from CNBC's wild man.</i>                                                        | 4  | 16                                                                                     | 7              | <b>FIND IT, FIX IT, FLIP IT!</b> Michael Corbett (Penguin • \$15) <i>Profiting from real estate, by a television-show host.</i>                                                    | 8                                                                                                         |  |            |
| 8                                                                                            | <b>THE ONE MINUTE MANAGER</b> Kenneth Blanchard, PhD, Spencer Johnson, M.D. (Morrow • \$19.95) <i>Three management techniques conveyed in brief story form.</i>           | 15 | 15                                                                                     | 8              | <b>THINK AND GROW RICH</b> Napoleon Hill (Ballantine • \$7.99) <i>Willpower and a positive attitude are the keys to achieving wealth.</i>                                          | 7                                                                                                         |  |            |
| 9                                                                                            | <b>THE TOTAL MONEY MAKEOVER</b> Dave Ramsey (Thomas Nelson • \$24.99) <i>Getting rid of debt and building up your rainy-day reserves.</i>                                 | 12 | 19                                                                                     | 9              | <b>THE INTELLIGENT INVESTOR, REVISED EDITION</b> Benjamin Graham, with Jason Zweig (HarperBusiness • \$19.95) <i>The classic treatise on "value investing."</i>                    | 11                                                                                                        |  |            |
| 10                                                                                           | <b>SUCCEED ON YOUR OWN TERMS</b> Herb Greenberg, Patrick Sweeney (McGraw-Hill • \$21.95) <i>Profiles of successful folks—and a personality test for yourself.</i>         | 14 | 2                                                                                      | 10             | <b>THE LEADERSHIP CHALLENGE</b> James M. Kouzes, Barry Z. Posner (Jossey-Bass • \$22.95) <i>The core concepts of leadership, with case studies and plans for action.</i>           | 14                                                                                                        |  |            |
| 11                                                                                           | <b>THE LITTLE BOOK THAT BEATS THE MARKET</b> Joel Greenblatt (Wiley • \$19.95) <i>The basics of "value investing" by a Wall Street veteran.</i>                           | —  | 7                                                                                      | 11             | <b>LEADERSHIP AND SELF-DECEPTION</b> The Arbing Institute (Berrett-Koehler • \$14.95) <i>A leader's motivation is what matters, says this business fable.</i>                      | —                                                                                                         |  |            |
| 12                                                                                           | <b>THE FRED FACTOR</b> Mark Sanborn (Currency/Doubleday • \$14.95) <i>Bringing creativity to your work and life, just like this mailman does.</i>                         | 11 | 18                                                                                     | 12             | <b>THE LEAN SIX SIGMA POCKET TOOLBOOK</b> Michael L. George, David Rowlands, Mark Price, John Maxey (McGraw-Hill • \$14.95) <i>A consultancy's guide to the management system.</i> | —                                                                                                         |  |            |
| 13                                                                                           | <b>THE LITTLE RED BOOK OF SALES ANSWERS</b> Jeffrey Gitomer (Prentice Hall • \$19.99) <i>"Fatal flaws" of selling and more.</i>                                           | 8  | 5                                                                                      | 13             | <b>THE TOTAL MONEY MAKEOVER WORKBOOK</b> Dave Ramsey (Thomas Nelson • \$17.99) <i>Whip your finances into shape.</i>                                                               | —                                                                                                         |  |            |
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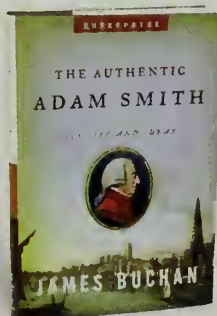
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Reviews and more are available at [www.businessweek.com](http://www.businessweek.com)

# Adam, We Hardly Knew Ye

**AUTHENTIC ADAM SMITH** His Life and Ideas  
James Buchan; Atlas Books/Norton; 198pp; \$23.95

For years, Adam Smith has been an icon, the Republican club-tie response to leftist students' Che Guevara T-shirt. Mocked by libertarians and Reagan White House operatives alike, the 18th century Scottish philosopher has been portrayed as a primary advocate of laissez-faire. To Alan Greenspan, he was "a towering contributor" to the modern world for his demonstration of the inherent stability and growth of what we now term free-market capitalism—all due to "an original version of Smith's invisible hand." The problem is, says James Buchan, Smith was far from doctrinaire free trader, favoring as he did "certain monopolies and restraints on trade, export subsidies and protections," and more. In his day, capitalism wasn't even a well-defined concept. And Smith's most famous turn of



phrase, the "invisible hand," appears only three times in his million-odd words—and not once in connection with global capitalist markets. In the insightful *The Authentic Adam Smith: His Life and Ideas*, Buchan frees Smith from current-day misrepresentations and resurrects him as a moral philosopher more concerned with ethical society than with pure economics. It's an engaging look at a man we thought we knew well.

Buchan is the author of several previous books, including an intellectual history of 18th century Edinburgh, Scotland—the milieu that fostered Smith, biographer James Boswell, and philosopher David Hume. In the current book he takes note of the severe limitations of the place and period. "Smith was brought up in a backward corner of an unmechanized world," in which "wages were so low it was cheaper to knit



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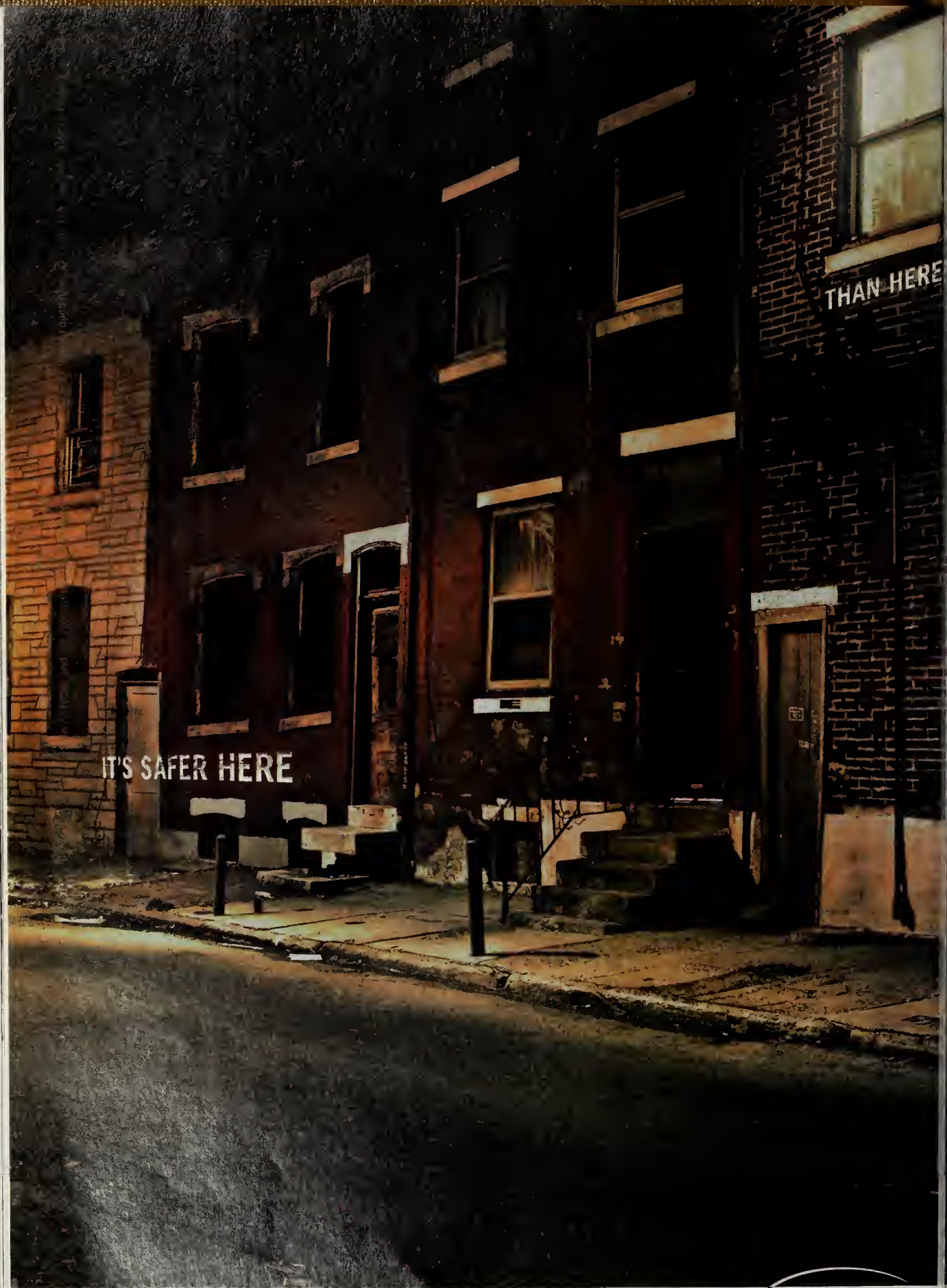
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things by hand than by machine.”  
 In 1723, Smith never married and  
 with his mother until her death  
 age 90. He attended a two-room  
 schoolhouse and then the University  
 of Glasgow. There, he concentrated  
 on moral philosophy,” a broad field  
 that encompassed basic jurisprudence,  
 politics, aesthetics, economics, and  
 more. Following several unhappy years  
 of study at Oxford University, Smith  
 returned to Scotland, and by 1751 he was  
 teaching moral philosophy at Glasgow.  
 His book would be *An Inquiry into the  
 Nature and Causes of the Wealth of  
 Nations* (1776) that would make  
 his reputation, selling out five  
 editions in his lifetime. But for Buchan,  
 his previous book is the truest key to  
 Smith’s thinking. *The Theory of Moral  
 Sentiments* (1759) was an inquiry into  
 the psychology of moral judgments.  
 Rather than drawing on divine law or  
 inherent moral sense, Smith asserted  
 that each of us derives our ethics by  
 evaluating other people’s actions. Then,  
 by putting ourselves in their position, we  
 make similar judgments about our own  
 actions. The resulting society was defined  
 by millions of individual choices rooted  
 in sympathy or fellow-feeling.”  
 Similar concerns about ethics and  
 justice impelled *The Wealth of Nations*,  
 Buchan says, behind which “is the  
 quest of an old-fashioned inquiry into  
 the moral character of luxury.” The  
 world had become prosperous, Smith  
 observed, to the general benefit of  
 mankind. How? The division of labor,  
 combined with freedom of occupational  
 choice, led to increased output and a  
 surplus beyond basic needs. Individual  
 self-interest ended up benefiting all.  
*The Wealth of Nations* is a long and  
 repetitive book that considers a host  
 of topics, from prices and the nature  
 of value to education. A revised 1784  
 edition had 13 new sections and 24,000  
 more words. And in 1789, a year prior to  
 his death, Smith made further changes.  
 While tending to justify the world as it  
 was, he had reservations, particularly  
 concerning any “conspiracy against  
 the publick” that arises from the  
 merchant class. He also worried over  
 the “disposition to admire, and almost  
 worship, the rich and the powerful.”  
 It may be inevitable that in such a  
 lawless world, adherents of a range of  
 views will find sustenance. But Buchan  
 makes a strong case that the just society  
 is ever Smith’s main concern. ■

—By Hardy Green



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## Stop Conflict Before It Starts

Dozens of countries have suffered through civil conflicts in the past few decades. The humanitarian consequences have been staggering: 3 million civilian deaths in Congo and hundreds of thousands more in Rwanda, Sierra Leone, and Sudan. The direct human impacts for survivors are enormous, and there may be lasting economic setbacks for whole societies.

Likewise, the regional spillover effects are devastating for neighboring countries faced with refugees, lawlessness on their borders, and the illicit trade in drugs and arms that often proliferate in conflict zones.

But what causes this instability, and what can be done about it? Recent research shows that what is called for is fresh thinking about how foreign aid should be structured, to head off civil conflicts before they ever start.

Oversimplifying a little, there are two main lines of inquiry among researchers about the causes of conflict. One set of theories stresses political repression. It predicts that violent clashes should be most likely to break out in dictatorships and ethnically divided societies. The second set claims deteriorating economic conditions are the key triggers sparking civil insurgencies. Indeed, extreme poverty can breed angry armed movements aiming to loot the assets and natural resources controlled by elites, especially when legitimate earning options are scarce.

Research by Oxford economists Paul Collier and Anke Hoeffler finds poverty and falling income are the critical drivers of violent conflict globally. Complicating the analysis, however, is something academics call reverse causality: Could violence be leading to poor economic outcomes in the data, rather than vice versa?

**TO AVOID THE PROBLEM** of reverse causality, my colleagues Shanker Satyanath and Ernest Sergenti at New York University and I employ an alternative statistical approach. Using annual data for African countries during the 1980s and 1990s, we estimate the effect of droughts on armed strife. Droughts lead to large drops in income in Africa, where most people rely on rain-fed subsistence agriculture. Droughts also have the analytical advantage of not being subject to reverse causality: Civil war does not cause drought.

Our research finds that a 5% drop in per capita income due to drought increases the likelihood of a civil conflict in the following year by nearly one half. That's a very large effect.

This analysis highlights the key role that economic volatility can play while suggesting some important real world implications for the design of foreign aid.

Currently, most foreign aid focuses on long-term investments in infrastructure or education but does little to deal with such short-term triggers of violence as drought falling export commodity prices. But our research suggests a larger share of aid should aim to dampen the sharp falls in income that actually generate recruits for rebel movements.

One possible solution is for more foreign aid to play an explicit *insurance* role. I call this new type of aid Rapid Conflict Prevention Support. RCPS aid would target countries

suffering temporary income drops due to poor weather or commodity price declines, both monitored by aid donors. Better yet, there would be little incentive for local regimes to "game" the system to receive such financing, since weather and global commodity prices are outside the control of any single country.

RCPS aid would bolster local economies when the risk of instability is high, but could be reduced quickly when conditions improve. RCPS might be most effective by providing temporary public works jobs for unemployed young men, the most likely to participate in armed violence. Insurance programs in more prosperous African nations, such as the Drought Relief Program in Botswana, could serve as models.

True, humanitarian aid also can serve as insurance. But usually provided after conflict has broken out. By contrast, RCPS would use economic indicators to identify nations likely to suffer future strife, increasing aid before violence erupts. Such prevention is better than a more costly cure.

Given the meager results of most foreign aid, alternatives like RCPS deserve serious consideration. Civil wars have claimed millions of lives and have created havens for criminals and terrorists. If RCPS could reduce the chance of conflict, even slightly, wouldn't it be worth it? ■

**Temporary foreign aid that targets sharp drops in income may stave off civil unrest**



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# Ideas **The Welch Way**

BY JACK AND SUZY WELCH

## A Twisted Chain of Command

**I work for a company where the information technology department reports to the head of finance. He never has time to evaluate IT projects, so IT gets attention only when there is a burning issue. This is a problem, isn't it?**

—Anonymous, Harare, Zimbabwe

It sure is. In fact, that sound you hear is the collective groan of hordes of people, just like you, who have watched this dysfunctional dynamic play out in their own organizations. And we're not just talking about IT getting buried or neglected until a crisis strikes, though that's bad enough. The more onerous problem suggested by your letter is the far-too-frequent Rasputin-like dominance of the CFO.

O.K., maybe Rasputin is a bit extreme. But it's not going too far to say that chief financial officers can, and very often do, wield too much influence within companies. And if it's not the CFO, it's the so-called chief administrative officer who has excessive power, overseeing finance itself, human resources, and any number of other staff departments. Whichever it is, this extra management layer generates bureaucracy at its worst. The person holding the CFO or chief administrative officer title inevitably becomes the company's mandatory go-to guy—the bodyguard through whom every question and decision must pass before reaching the CEO. Their jobs become catch-all bins for projects, people, or whole departments that the “overburdened” CEO, with just too many direct reports, is said to be too busy to deal with. It's just wrong.

So why does it happen? With IT, the explanation is easy: It's an historical hangover. Initially, IT was mainly seen as good for lowering costs and increasing efficiency. In those days, decades ago, there was some logic to having IT report to the CFO. Most good companies, however, took IT out of finance when its broad strategic utility became obvious. Others, apparently yours included, did not.

As for HR reporting to a chief administrative officer, there can be no good explanation for such a situation. With its critical role in hiring, appraising, and developing people, HR is so central to success that it's practically criminal if the department doesn't report directly to the CEO. When it doesn't, you can only assume the CEO doesn't get the people

thing, someone else is actually running the place, or both.

Which brings us to the consequences of this dismal situation. The first is that front-line IT and HR managers, usually have among the most relevant ideas and information do not get heard high enough up in a timely way. Their insights often get filtered before making it to the CEO or the board by the cost-sensitive CFO, of all people!

And companies where the CFO or chief administrative officer reigns supreme have a much harder time attracting top people to HR and IT jobs. The best and brightest will always choose to work where they have a seat at the table equal to the CFO. Why shouldn't they? Smart companies recognize their value and reward them with pay and prestige.

So, absolutely, IT shouldn't be reporting to the CFO. No function should report to a bureaucratic layer. Your painful common problem makes clear why that is so.

**Are consultants good or bad? Under what circumstances would you bring them in, and what does bringing them in say about the skills of your own people?**

—Kendra Stringfellow, Albany

Your question is sort of like asking: “Are doctors good or bad?” The answer is, some are good, some are bad, but in any way, you want to spend as little time with them as you can.

Look, the problem with consultants is they're fundamentally (if surreptitiously) at loggerheads with managers. Consultants want to come into a company, solve the mess, and then hang around finding and solving other messes—forever. Managers want consultants to come in, solve a specific problem fast, and get out, also forever. The tension between these conflicting goals is what makes the use of consultants intractably problematical.

Certainly, consultants can be useful. Sometimes a company needs fresh eyes to assess an old strategy or a product. Sometimes a company simply does not have the in-house skills needed to make an informed decision. These days, private equity firms are effectively using consultants to evaluate the markets and industries of potential acquisition targets.

But in any dealings with consultants, the byword is “caution.” Before you know it, they're doing bread-and-butter work like strategic planning—your work. After all, that's what they want, even if you don't. ■

*Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at [thewelchway@businessweek.com](mailto:thewelchway@businessweek.com). For their weekly podcast, go to [businessweek.com/search/podcasting.htm](http://businessweek.com/search/podcasting.htm)*



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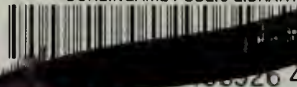
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# BusinessWeek

SEP 25, 2006

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## What's Really Propping Up the Economy



Health care  
has added  
1.7 million  
jobs since  
2001. The  
rest of the  
private  
sector?  
**None.**

BY MICHAEL  
MANDEL  
(P.54)

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A photograph of a dark interior space, possibly a barn or a stable. A window in the upper left shows a bright sun in a clear blue sky, with dark mountains visible on the horizon. The foreground is filled with a thick layer of yellow straw bedding. A white, curved object, possibly a piece of equipment or a part of a structure, is visible on the right side of the straw.

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system as reliable  
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## STRONG MEDICINE

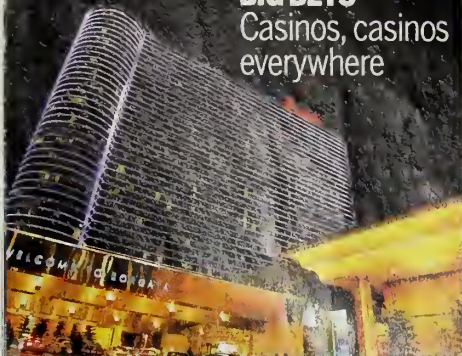
Health care has added 1.7 million jobs since 2001. The rest of the private sector? None



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Casinos, casinos everywhere



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## DO OVER

Turning junk into gold



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**A Trade Gap that Just Keeps Growing**  
The numbers show just how ravenous U.S. consumers are for Chinese goods

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Raw materials costs have more companies turning to remanufacturing and saving big bucks

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### ights, Ideas, and Lessons

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For design and innovation quarterly readers a toolkit for those looking to build a culture of creativity

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U.S. gamblers' appetites keep up with huge industry expansion—from Atlantic City to Biloxi to Las Vegas?

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It's a flash point for many communities

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Why bears are betting against Jarden

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Where you shop may reveal your politics

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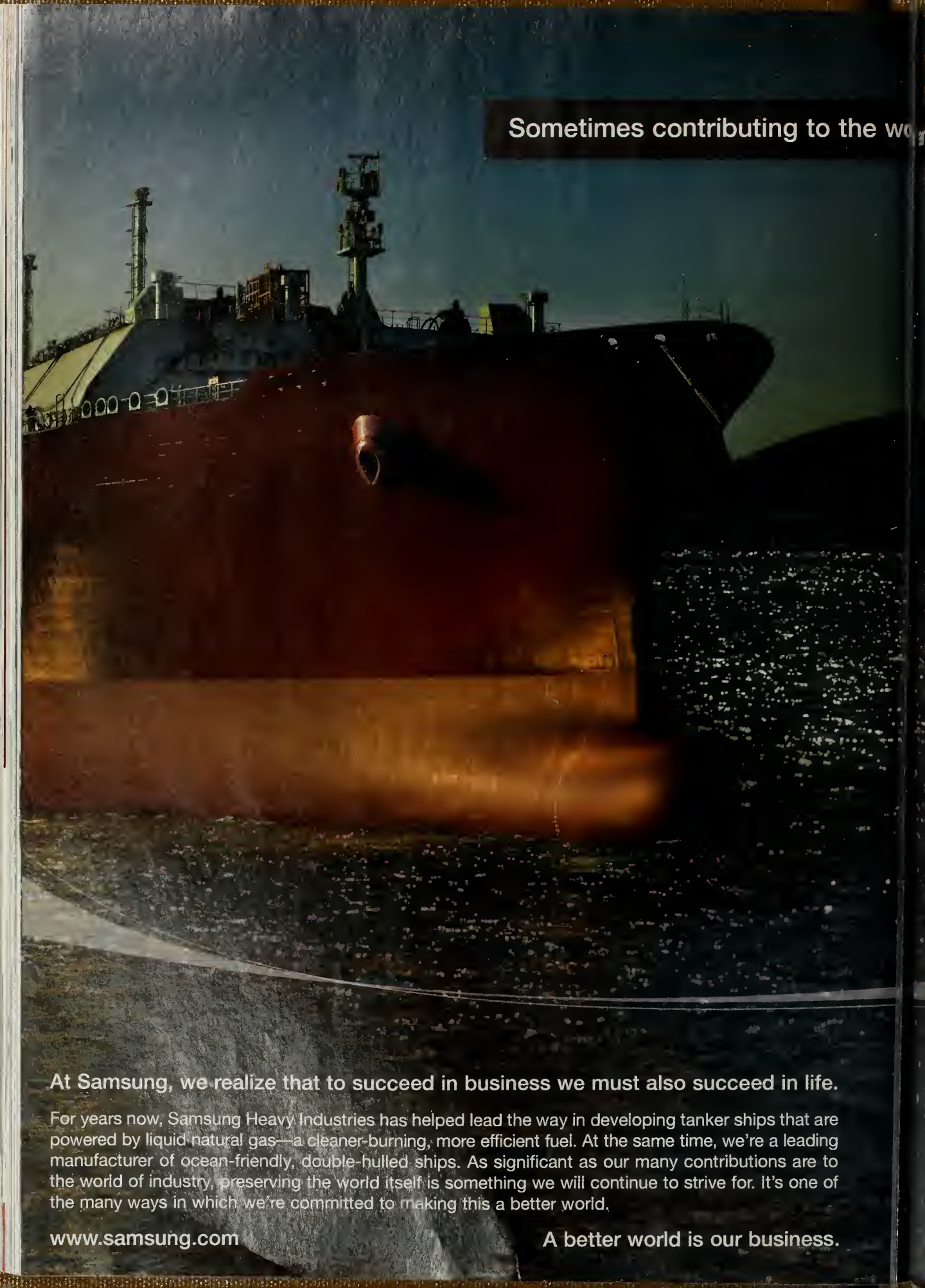
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## THE WALL STREET JOURNAL.

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FRIDAY, AUGUST 29, 2006 • VOL. CXXIII NO. 41 • \$1.00

When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

LIQUOR BRAND/PRICE\* OUR AWARD

### TOP 3 GINS

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\$30/750ml Flavorful

**Tanqueray No. Ten** Smoothest  
\$26/750ml

**Juniper Green Organic** Best  
\$26.50/750ml Presentation



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# What's Hot This Week At BusinessWeek.com

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## MySpace or Yours?

Social networking Web sites aren't just for teens anymore. BusinessWeek.com's **CEO Guide to Technology** looks at how companies are using online networks for sales, marketing, and branding. Recruiters at Microsoft and Starbucks, for instance, troll the Web for potential job candidates. Deloitte & Touche and Goldman Sachs built their own alumni networks to **strengthen bonds with potential clients**. And Intuit and MINIUSA are trying to build brand loyalty by connecting with customers. Reid Hoffman, CEO of LinkedIn, the biggest business networking site, explains in a podcast how online communities can help executives **find employees and forge partnerships**. Find out why JPMorgan Chase and Burger King launched marketing campaigns on Facebook and MySpace instead of their own Web sites. Of course, online social networks are an international phenomenon: **Competitors to MySpace**—including Bebo.com, Ringo.com, and Spanish music social networking site MyStrands—are cropping up in Europe. And in Asia, mixi, Cyworld, and other sites are gaining a foothold. For all this and more, go to [www.businessweek.com/technology/ceo\\_guide](http://www.businessweek.com/technology/ceo_guide)

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"The world is changing, and so is Dell."

—CEO Kevin Rollins, promising a turnaround after recent setbacks, including a widening federal inquiry into Dell's accounting

EDITED BY DEBORAH STEAD

## EUROPE HAVE McPASSPORT, WILL TRAVEL

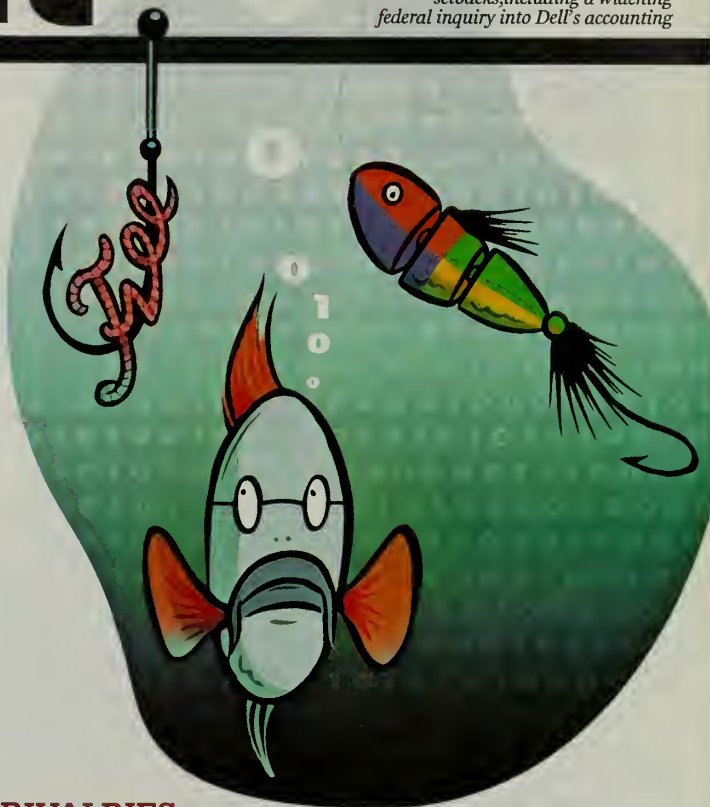
MCDONALD'S unveiled a program on Sept. 12 that makes it simpler for its 5,000 European workers to find jobs at its outlets anywhere in the EU. Despite the region's chronic high unemployment, companies say jobs often go begging because few candidates will relocate. Indeed, EU officials applauded the program as the first major effort by an employer to tackle the lack of labor mobility. Just 1.5% of Europeans live and work outside their own countries. Surveys, 60% say they wouldn't make such a move even if they were jobless.



Hoping that its relatively young workers are more inclined to pick up stakes, McDonald's is creating a Web site for employees to find openings and issuing "McPassports" that qualify them for jobs at any outlet. "If they are trained and they need a job, they will get it wherever they are in

Europe," says Denis Hennequin, McDonald's European chief.

Well, almost. To wait on customers, they must speak the local language. And McDonald's says it can't guarantee jobs to Central and Eastern Europeans, who still face restrictions on cross-border employment. Even so, the McPassport may make for interesting talk among workers in the kitchen. *Hamburguesa mit frites, presto!* —Carol Matlack and Michael Arndt



## RIVALRIES

# Microsoft Plans Some Net Fishing

MICROSOFT is gearing up for a new game of catch-up with Google, this time to compete with Google's Web-based word-processing and spreadsheet services. *BusinessWeek* has learned that the software giant is making plans to put some of the technology from Works—the bare-bones word-processing and spreadsheet software that often ships with new consumer PCs—at the heart of a new online offering. The company is developing a strategy to offer the service free, hosted on its Office Live Web site. There may also be a subscription version with more bells and whistles.

While it's not a done deal, Microsoft is putting plenty of bodies on the project. "We want to win this space," says Chris Capossela, vice-president for the business division product-management group. The service will probably take shape sometime after the company launches Office 2007 early next year. The idea will be to provide minimal functionality so as not to eat into Office sales. Microsoft could be bolder, says Goldman Sachs software analyst Rick Sherlund, perhaps giving away some of its valuable Office technology free on the Web to counter Google, even at the risk of cannibalization. "You need to be aggressive in dealing with Google. Don't tie your hands behind your back. Come out swinging."

—Jay Greene

## THE BIG PICTURE

THINK YOUR WORKPLACE is like a sitcom? An online survey, Staffing.org, a performance search firm, asked 300 people to describe their company's culture using one of four fictional touchstones. The results:

Not like  
the  
"Office"



7%

"More like  
Dilbert  
than I'd  
like to  
admit"

24%

"M\*A\*S\*H,



on a good  
day"

14%

"Like  
Leave It to  
Beaver"



5%

Data: Staffing.org



## COURT CALENDAR

### A TEST FOR CONFLICTED CONSULTANTS

A LONG-SIMMERING debate about conflicts of interest between public pension funds and the consultants who advise them may get its day in court. On Aug. 25, Patrick Patt, a retired school

Exchange Commission said that more than half of 24 consultants it studied for conflict of interest provided services to both money managers and pension funds. The SEC doesn't prohibit these activities, though the agency has issued "tips" for consultants, including suggestions that they disclose payments from money managers to their pension fund clients and implement firewalls to prevent such payments from influencing investment decisions.

Nancy Malinowski, a Callan spokesperson, says the Illinois suit's conflict-of-interest allegations are "absolutely untrue" and that Callan intends to fight the suit. "There's nothing inappropriate about our business model," she said, adding that the Illinois fund performed well enough to be in the top 10% of funds its size for the four years Callan advised it.

—Christopher Palmeri



superintendent from Lake Forest, Ill., filed a lawsuit against **Callan Associates**, one of the nation's largest fund consultants. A beneficiary of the Illinois Teachers' Retirement System, he claims the consultancy violated a state law that requires a fiduciary to act solely in the interest of the fund it represents.

According to the suit, filed in state court, Callan earned \$545,000 a year from 2002 to 2006 as the lead investment adviser to the \$36 billion pension fund. But even as Callan was helping pick money managers for the fund, the suit alleges, it was earning up to \$54,000 a year from money managers attending its seminars. In part, these seminars teach money managers how to win business from pension funds.

The suit does not allege any favoritism on Callan's part. But the consultants, says J. Brian McTigue, one of the attorneys who filed the lawsuit, "need to be unconflicted."

Such practices are common in the world of fund advisers. In a report issued last year, the **Securities &**

## MILESTONES

**MUPPETS TAKE MOSCOW** Sesame Workshop, the nonprofit behind *Sesame Street*, is celebrating its 10th year in Russia in mid-September with a children's art show at Moscow's Tretyakov Gallery.

Public donations are rare in Russia, so *Ulitsa Sezam* has relied in the past on funds from USAID and even George Soros, whose foundation kicked \$1 million in 1996. Today, "the rock" of its support is Nestlé, says Sesame Workshop President Gary Knell. Nestlé, which has put *Ulitsa Sezam* Muppets like Zeligoba (above) cereal boxes in Russia, is launching a branded "Good Nutrition Program" in 5,000 schools throughout the country.

—Bremen Le



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FIVE-STAR

HIGHEST GOVERNMENT  
FRONT-IMPACT CRASH RATING





## CLICK MAGNET



## BUILDING A BETTER MOUSETRAP

Savvy bloggers sift through thousands of posts and newsfeeds every day to find the magic topics that will send search engines racing in their direction. But Mike Levin, the creator of **hittail.com**, thinks he's got a better way: To become a click magnet, he says, a blog should study how it got its past hits.

To advise bloggers on what's bringing readers to them, **hittail.com** uses software based on "long tail" theory. It ignores the most common terms that call up a blogger's Web site on a search engine's results page, analyzing instead a large sample (the long tail) of many other phrases that have led searchers to the blog. It then regularly suggests a list of a half-dozen "headlines," topics that should keep the traffic coming. Bloggers need only supply the posts, Levin says. Michael Duz, whose blog, **SEO-blog.com**, is about search optimization, gives the service, now free, good reviews. "The more content you add," he writes, "the more long-tail search terms will become apparent, for which you write more content." —*Jessi Hempel*

## HAWK SHOW

## ADDING SOME SPARKLE TO QVC

SOON, IT WON'T be your mother's **QVC**. At least that's what executives at the \$6.5 million-a-year TV shopping channel are hoping. To youth-ify its audience, now mostly 40-to-60 year old women, the electronic retailer, owned by **Liberty Media**, is booking celebrity types with youth appeal.

Viewers have already been pitched by Paula Abdul (above), who took a break from rehearsals for the *American Idol* finale in May to sell rings and necklaces from a special QVC stage outside of Hollywood's Kodak Theatre. Also hawking from Hollywood: Cynthia Garret, a **VH1** veejay, who hosted a jewelry segment while poolside at the trendy Roosevelt Hotel, another of the nearly 40 remote broadcasts QVC will do this



year. (From New York City's Trump Tower, competitors on NBC's *The Apprentice* have hustled to win approval from The Donald by selling panini grills and cleaning liquids.)

It's all part of CEO Mike George's "cultural relevance program," aimed at wringing more sales out of the estimated 91 million U.S. homes that receive the channel. Now, only about 1 in 10 of these households buy products, George says. "If we can get someone to stop on the channel for 10 seconds longer than they might, our chances

of getting them to buy go up dramatically." The channel's revenues increased a robust 14% in 2005, but that growth rate may diminish, since QVC is already available in every cable and satellite home.

QVC's hefty audience must attract buzzworthy types. Model Heidi Klum was slated to appear on Sept. 14. Other young celebs are showing interest, too, says marketing chief Jeff Charney. "We used to call agents all the time and never get a call back," he says. "Now they're the ones calling us." —*Ron Grover*



## CAR TALK

## WHAT DO WE NAME THIS BABY?

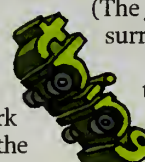
**KIA MOTORS** has announced the name of the snappy new subcompact hatchback it will sell in Europe. Ready? It's the Ceed (short for "Commission Européenne" and "European Design"). It's the same name Kia used for a "concept car," much like the final product, introduced at the Geneva Motor Show in March. Covering the show, *Motor Trend* went so far as to

say: "We hope [it] is not the production version's name."

Sorry, *MT*. Then again, Kia isn't the only automaker having trouble in the name game. The U.S. trademark registry reveals some of the other names and slogans being protected (or given up) by car companies. What may come down the pike? Kia is protecting Seragio for a future model name in the U.S., while **Volkswagen** has re-registered Scirocco, a name (meaning roughly, "warm wind") it plans to bring back from the 1980s. Sadly, VW gave up protection for the

name The Thing and the ad slogan "Fahrvergnügen" (The Joy of Driving). It also surrendered Zoon.

**Ford** has had a devil of a time settling on names for its Lincoln models. After just a year marketing a compact sedan as Zephyr, Ford is renaming it. The former gentle breeze will be the in the fall. And as the old Town Car drifts into memory, it will be replaced by the MKS. Ford is also guarding MKSW and MKV in case another company wants to steal those names. No worries, Ford. —*David*





# HOW DO YOU DEAL WITH AN ENEMY THAT HAS NO GOVERNMENT, NO MONEY TRAIL AND NO QUALMS ABOUT KILLING WOMEN AND CHILDREN?

The enemy is Mother Nature. And on August 29, 2005, in the form of Hurricane Katrina, she killed 1,836 people, devastated a land area larger than Great Britain and caused over 100 billion dollars worth of destruction. Even when her wrath isn't as grand, she is still accountable every year for almost 500 American deaths and 14 billion dollars worth of damage.

## **It's time we started fighting back.**

Today, Congress is working with state and local officials and the private sector to create a financially responsible solution to prepare and protect Americans from future natural catastrophes like hurricanes and earthquakes. H.R. 4366 uses insurance premiums — not tax dollars — to create a financial backstop against

disaster and help Americans better prepare themselves for these events. It is truly a cause worthy of your and every American's support.

## **GET YOURSELF TO THE FRONT LINES.**

Visit [www.protectingamerica.org](http://www.protectingamerica.org) and urge Congress to get our country ready for the next big attack.



## ANALYZE THIS

BY KERRY SULKOWICZ, M.D.

# Managing the Pink Slip Blues

**I'm a therapist practicing near Detroit, where layoffs are a frequent threat. (When they arrive, it's almost a relief for my patients.) How can a corporation handle these (including the rumors) so that morale isn't destroyed? And how can laid-off employees realistically assess their competence after being dismissed because of market forces?**

—S.H., Plymouth, Mich.

**YOU'VE GOT YOUR** hands full, practicing near Motor City. While layoffs are sometimes required to save a company during downturns or after a strategic miscalculation, they can cause devastating emotional harm. Morale suffers not only because the dismissals signal serious internal problems but also because of the loss of colleagues—and survivor guilt among those who escaped the ax.

Because the threat of layoffs puts people under chronic strain, employees may indeed be relieved when the pink slip arrives and the suspense is over. But anger, depression, embarrassment, and plummeting self-esteem can follow quickly.

Here's one thing companies can do: Openly acknowledge the suffering they're causing. Calling layoffs "downsizing," "right-sizing," or

"adjusting to scale" is an attempt to deny the trauma. It depersonalizes the humans who are suddenly out of work, downplays the aggressiveness of the action, and is a way to assuage the guilt of those making hard choices about who stays and who goes. The only thing worse than being fired when you haven't done anything wrong is that awkward silence from leadership. It leaves you feeling at fault by default.

Senior managers also need to know that unaddressed rumors about impending layoffs will spread rapidly, paralyzing an organization. And they shouldn't assume that those left behind, including themselves, will be unscathed by the experience. (My CEO clients agonize over these decisions.) Through HR or other professionals, senior managers should be attuned to the emotional fallout, including survivor guilt and lingering anxiety. Getting employees to put their feelings into words is one of the best ways to help, though it's remarkable how often people are afraid to do just that.



**FOR THE OUT-OF-WORK** employee, the big challenge may be how to cope with feelings of helplessness and rage. Being laid off isn't like being fired for cause. It's not a chance to learn from one's mistakes, and there's no easy or obvious solution: It's not so easy to move to a less vulnerable city or industry, for instance. And

while most people are rational enough to know that their competence was never the problem, our minds don't work logically at these times. Self-doubt and anger turned inward take a toll. That's why the therapy in this case is to redirect that anger

toward finding a new job. Even the necessity of listing one's skills for a potential employer is useful. It's a reality check that counters the distorted self-image that depression breeds. Counseling can help, but getting another job is, ultimately, the best medicine.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executives on psychological aspects of business. Send questions at [analyze@businessweek.com](mailto:analyze@businessweek.com).

## QUESTION OF THE WEEK

The spotlight is still on Hewlett-Packard over the use of "pretexting" to get board members' and journalists' phone records in an attempt to trace news leaks. A corporate blunder? Something bigger? —Nanette Byrnes

**"I'd never heard of this euphemism for impersonation. Impersonating a police officer is a crime. Should that extend to impersonating other people? I think so. I'm a privacy nut, and this is a way of invading privacy. There ought to be a law."**

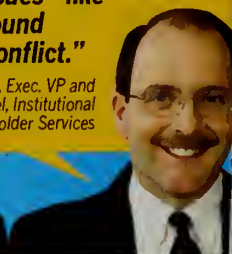
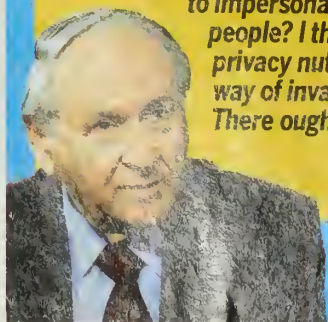
William Safire,  
Columnist, The New  
York Times Magazine

**"'Pretexting' is really identity theft. The legality is almost less relevant than the ethics. The issue of leaks is very real. But if you have a leak and a problem, you get at it legally or you have to endure it."**

Harvey L. Pitt,  
Former Commissioner, SEC

**"People are missing the real story at HP. Post-Enron, boards have been granted all this new power, but they haven't had time to deal with their own internal issues—like setting ground rules for conflict."**

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1987

1993

1600

1200

800

400



See below for an explanation of this chart. Represents performance period 12/31/86 through 12/31/05.

## EQUITY RESEARCH

### RATINGS

Since 1987, Standard & Poor's 5-STARs stock recommendations have outperformed the S&P 500 in 15 of 19 years and tied once, and have outperformed the Dow Jones Industrial Average and NASDAQ Composite Index in 14 and 13 of those 19 years, respectively. The above chart represents the hypothetical growth attributable to price appreciation of a \$100 investment in the 5-STARs portfolio for the period shown. Since 1987, S&P has ranked a universe of common stocks based on a given stock's potential for future performance. Under our proprietary STARS (STock Analysis Ranking) system, S&P's equity analysts rank stocks according to their individual forecast of a stock's future total return potential versus the expected total return of the S&P 500 index, based on time horizon. STARS are ranked 1 to 5, with 5-STARs stocks expected to outperform the S&P 500 index by the widest margin. \*\*\*\*\* 5-STARs (Strong Buy): Total return is expected to outperform the S&P 500 index by a wide margin over the coming 12 months, with shares rising in price on an absolute basis. "S&P," "S&P 500," "STARS," and "Standard & Poor's" are trademarks of The McGraw-Hill Companies, Inc. The 5-STARs model performance graph is only an illustration of S&P's research. The 5-STARs portfolio is not an actual portfolio and 5-STARs performance does not represent the results of actual trading. Thus, the performance shown does not reflect the impact that material economic and market factors might have had on decision-making. While 5-STARs stocks performed better than the above indices for the period shown, the performance during any shorter or longer period may not have, and there is no assurance that they will perform as indicated in the future. STARS methodology does not take into account any particular investment objective. Investments based on the 5-STARs methodology may lose money. There is no guarantee of performance of 5-STARs recommendations made in the future will equal past performance. STARS performance does not take into account reinvestment of dividends, capital gains, taxes, or brokerage commissions and fees. The imposition of these fees and charges would cause actual performance to be lower than the model performance shown. The stocks ranked 5-STARs will change over time.

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2005

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S&P 5-STAR  
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The final proof that men are now as self-conscious as women is the so-called retrosexual backlash against metrosexuality."

—Mark Simpson  
London

### MALE SHOPPERS: METROSEXUALS, GEARHEADS, AND CHEAPSKATES

AS THE "FATHER" of the metrosexual (and also apparently of his antithetical brother, the retrosexual), my attention was drawn to "Secrets of the male shopper" (Cover Story, Sept. 4). Since Nanette Byrnes talked so much about my offspring, it would have been nice if she had contacted me to check some of her metro family history. When I first wrote about him in a U.K. newspaper in 1994, I was not being insulting. Amused yes, but fondly so. Ambivalence was to come later.

Nor did the metrosexual somehow "surface" in the U.S. 10 years later. He was introduced stateside by his father in 2002 in "Meet the metrosexual" on salon.com. If I'd known what was coming, I'd have grounded him in the U.K. American marketers abducted him with false flattery and did their best to turn him into an annoying fad, talking incessantly about the metrosexual as "sensitive" and "in touch with his feminine side." Metrosexuality is only "feminine" if you believe vanity's name is (forever) Woman.

Ironically, the final proof that men are now as self-conscious as women is the so-called retrosexual backlash against metrosexuality. As your figures for boom-

ing male consumerism show, it's really retrosexual at all. It's faux-retrosexual. It's Calvin Klein model Brad Pitt leading the rebellion against consumerism in *Fight Club* all over again. "Regular guys," whatever they are/were, are fast becoming just another annoying fad.

—Mark Simpson  
London

THANKS TO MARKETERS finally paying attention to me, I am now buying what I did not know I needed. I have been transformed from a "fat, dumb, happy" male to a "lighter, smarter, insecure" man.

—Dennis V.  
Westport, C.

I JUST FINISHED skimming "Secrets of the male shopper." I am telling you now, if you want to score big with the majority of these men, you need to market them almost as if they were children (and self included). Remember Sears' Gammals [clothing for children]? You need to develop a slightly—and I mean slightly more mature way of allowing me to walk into a store and, on their own, not clothing with a satisfying level of con-

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# ReadersReport

dence. We need to be able to walk into a store and grab a No.7 suit, No.7 shirt, No.7 tie, etc., and walk out.

Remember: Most of us hate to shop. We don't like to ask for directions when we are lost, and we don't like to ask for help when we shop!

—Joe Brooks  
Holland, Pa.

SORRY, FOLKS, but I don't fit any of your five male shopper categories. I'm 71 and don't look like those youngsters in your article. When I have to shop, I do it with a list in hand and stick to it. Shopping malls are fine, but only if they have somewhere I can sit down and wait. That being said, my wife correctly points out that I'm a gearhead. Biking gear, cross-country ski gear, birding gear, radio gear, fishing gear, etc. I've even got three kayaks—why do I need three? Maybe this could be a sixth category: the gearheaded multination shopper.

—Don W. Calbick  
Moses Lake, Wash.

YOU MISSED an additional significant category: the Total Cheapskate. This guy only buys what he needs and always looks for bargains. Shaving cream? Why spend the money when ordinary bath soap suffices? Fashion? Forget it! My wife and kids have accused me of coming back in style at least three times.

You can't market to the Total Cheapskate. It doesn't work. The only exceptions are new technology and new tools. That's because the Total Cheapskate is always looking to save time as well as money.

—Andres Peekna, President  
Innovative Mechanics Inc.  
Waterford, Wis.

YOU MENTION the Web's interactivity in your interesting article but fail to emphasize two important features of the Web that have revolutionized men's consumerism: confidentiality and privacy. The Web has given men a private and confidential medium to get information and find out about products they might otherwise be too shy or embarrassed—or simply too lazy—to get. Using your example: Few men would walk into a store and inquire about a “below-the-neck razor.” Online, they will gladly interact with the product. Grooming is one beneficiary of this privacy, and health is a more important one.

—Ashkan Karbasfrooshan  
Montreal

YOUR RECENT cover story left out a very important male consumer segment: the gay male. Recent reports estimate gay/les-

bian adult purchasing power at \$485 billion, and gay males, despite their small number (estimated at 5% of the population), shop disproportionately more than their straight counterparts and are highly influential in spreading the word on new and innovative products. This fact has been lost on many companies and brands that market to gay men, including Absolut, Budweiser, Ford Motor, GlaxoSmithKline, L'Oréal, Nivea, Procter & Gamble, Ford Bull, and Volkswagen, to name a few.

—Steve Deitsch, Founder/President  
Reverberate! Market  
Communications Inc.  
New York

MEN IN THEIR forties and fifties are their peak earning years. You'd never know this, seeing the models featured in most advertisements for men's products. Whether it's clothing, cologne, travel, cars, I can search through issue after issue of *GQ*, *Esquire*, or other men's publications without seeing anyone over 40, except in ads for drugs to lower or raise various things.

—Peter New  
Chelmsford, Mass.

## CORRECTIONS & CLARIFICATIONS

In “The greenest house on the planet” (*Environment*, Sept. 11), the light-emitting diodes used throughout the house are from Permlight Products Inc., not American Permalight Inc.

“Did Scholastic deserve that punishment” (*Inside Wall Street*, Sept. 11) should have said, “the sales of \$195 million worth of Harry Potter books added 60¢ to fiscal 2006 earnings, which ended May 31,” rather than “should add 60¢ to 2006 earnings.”

## How to reach *BusinessWeek*

### LETTERS FOR READERS REPORT

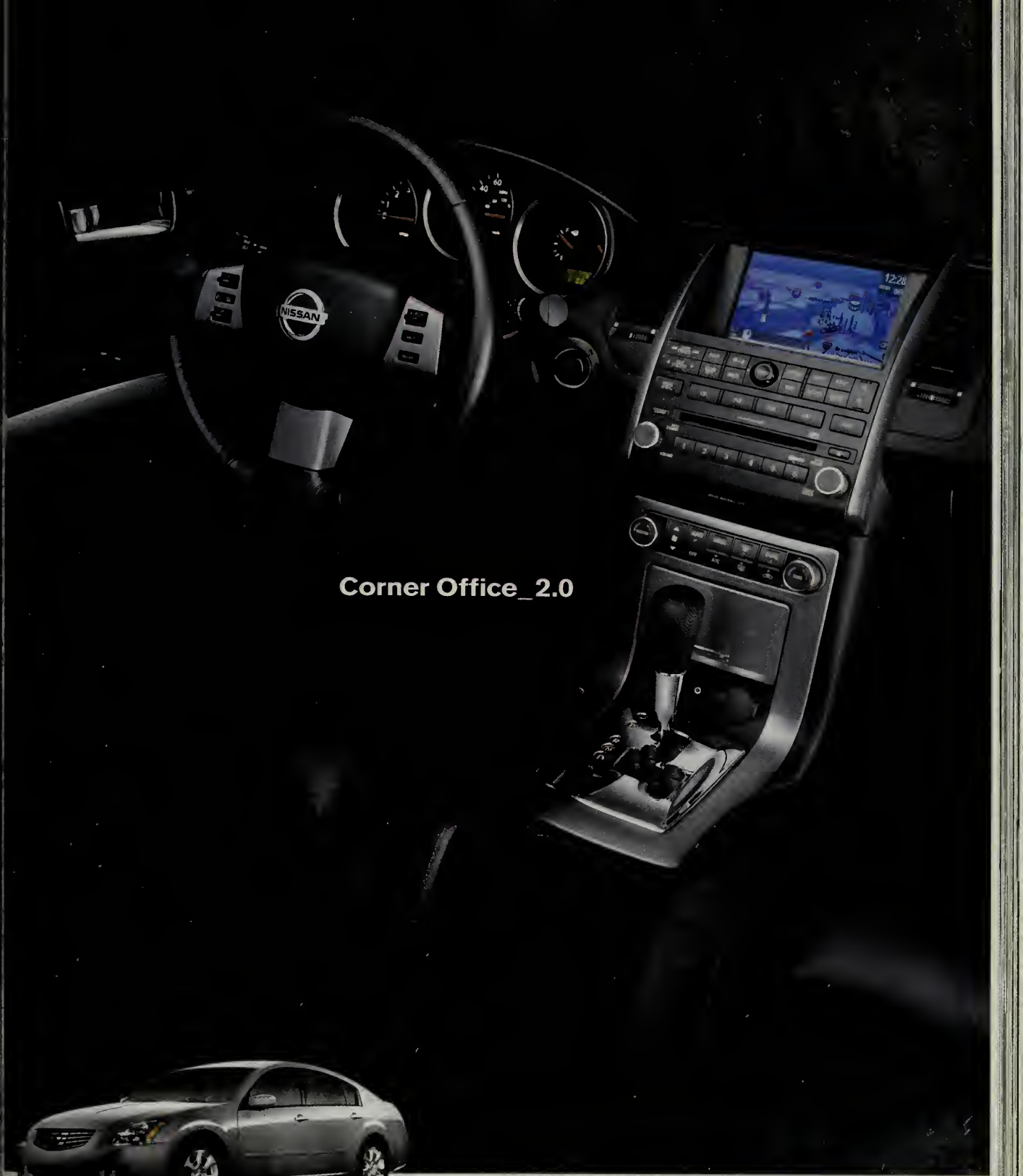
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# More Vroom for the Buck

In an age of \$300 desktop PCs and \$500 notebooks, why pay \$2,500 or more for a computer? For most of us, spending that kind of money for a new Apple Mac Pro makes as much sense as buying a Ferrari Scaglietti for commuting in urban traffic. But for a class of people whose work—or play—demands maximum power, the Mac Pro is almost a bargain.

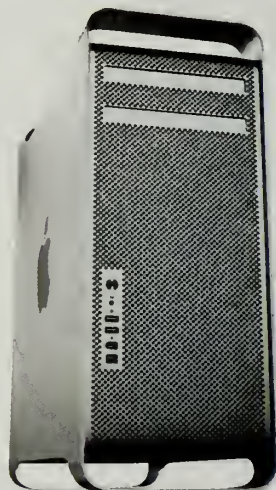
The computer looks like the Power Mac G5 it replaces, in the same big and handsome brushed aluminum case. Instead of IBM G5 processors, though, it runs on a pair of Intel Xeon chips designed for servers and high-end workstations. That means there are a total of four processor cores—two for each Xeon.

Who needs the computing equivalent of a V-12 engine? The main audience is Apple's traditional core market of creative professionals: graphic artists, photographers, musicians, and video- and filmmakers, along with scientists, designers, and engineers. But the Mac Pro also holds great appeal for serious amateurs, whether they're editing video, doing digital darkroom work on the photos from a 10-megapixel camera, or mixing the latest tracks recorded by their band.

Although Apple is sometimes accused of overpricing its wares, that rap won't stick with the Mac Pro. When I configured a Dell Precision 490 workstation to match the base Mac Pro as closely as possible, the price came in at \$3,033, upward of \$500 more than the Mac. Even a much less capable Dell Dimension 9200 came in at \$1,840 when tricked out to approximate the Mac.

**APPLE'S FREE SOFTWARE BUNDLE** is another Mac advantage. True, a professional musician would probably pay the \$999 Apple charges for Logic Pro music creation software or go with the pricier Avid Pro Tools system. But someone else—a photographer who spends \$800 for Adobe Creative Suite 2, say—might enjoy dabbling with the free GarageBand music program or making a quick video in iMovie.

I put a Mac Pro through its paces after returning from a South American vacation with several hours of digital video tape and about 1,500 digital photos. I edited video and audio using Apple's \$399 Final Cut Express HD and the Soundtrack



audio program that is part of it, processed photos using Adobe Photoshop CS2, and created DVD movies and slide shows using the bundled applications iDVD and iPhoto.

This sort of work is never easy. Getting an audio mix right, for example, can mean listening to the same bit of sound time over and over as you try different adjustments. You want to like these, which are responsive and unobtrusive. Then there's the display screen area. You can't have too much of this for creative applications, and the Mac Pro makes it simple to

**The Mac Pro, with the equivalent of a V-12 engine, is cheaper than a tricked out Dell**

hook up two monitors—much easier than on any Windows system. Finally, video work demands a lot of waiting for the machine to finish a task. The Mac Pro kept those waits to a minimum while meeting the job's stupendous appetite for storage space. (The maximum of four 500-gigabyte drives should be plenty for almost anyone.)

The new Mac Pro complements Apple's transition to Intel processors. The company has also upgraded its iMac line to the Core 2 Duo chips and cut the price of the 17-in. model to \$999 while adding a 24-in. version at \$1,999. But one thing keeping these systems from peak performance is a lack of software optimized for Intel. Adobe, for example, has not given a timeline for such key creative tools as Photoshop and Macromedia Flash. The versions for older Macs work fine but don't deliver the speed gains the Intel models are capable of.

The Mac Pro offers far more firepower than the typical browsing the Web and reading e-mail is ever going to require. But for the passionate minority who want and are willing to pay for performance, it is a very tough system to beat. ■

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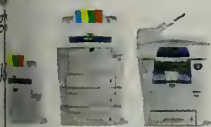


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## Distribution is Queen

The comic **Sandra Bernhard** titled a one-woman show *Without You I'm Nothing*. The media company corollary is, without content there is nothing. ¶ People don't want to watch a cable system; they want to watch *Breaking Up With Shannen Doherty*. (Or not, but bear with me.) The notion that the content you own will one day pay off massively is held dear by

every media company.

Sadly, the stock market has yet to show the love for this view. Viacom Chairman Sumner M. Redstone is credited with the coining of "content is king." But expectations are high that his new CEO, Philippe Dauman, will soon buy a big next-generation Internet distribution play. So high that, were YouTube a public company, one analyst says its stock would have jumped \$10 on the day Tom Freston was let go for insufficient ardor in pursuing things Internet.

In late 2006, owning content isn't enough if you're still pushing it through printing presses, cable systems, even standard-issue Web sites. What works for a media company's stock price right now is the whizbang pairing of content with some kind of next-generation distribution. Think News Corp. and MySpace.com: A Web site that links users' pages and is visited by more than 49 million people in a month is a network, and thus a means of distribution. Think Disney moving first to sell its TV shows, and now 75 of its movies, on iTunes. These are practically the only big-media stocks that have risen in the past year. (Another is Viacom's sibling CBS Corp., which streamed the NCAA basketball tournament online in March and is launching the broadband channel Innertube.)

**SHOULD YOU THINK IT'S ONLY A DIGITAL-MAD** market overvaluing anything dot-com, pause to consider that Google's and Yahoo!'s stock prices have spent months going sideways or falling. "We talk about content vs. distribution," says Aryeh Bourkoff, a managing director of UBS, referring to the long-standing truism that companies are best off focusing on one of the two. "But the coalescence of those two factors in a new medium is really where business models will flourish."

Emphasis on the "will" part. Consumers buy video iPod downloads, but current volumes don't mean much to a \$33 billion company like Disney. Bourkoff says MySpace will gross over \$300 million in 2006 but won't turn profitable until later this year. (A News Corp. spokeswoman pegged revenue at \$350 million and would not comment on profitability.)



**These days, content needs a next-generation mate**

Nielsen NetRatings data show that visitors to MTV.com, MySpace.com, and iFilm shrank by double-digit percentages in August. (AOL's audience declined less drastically.)

Meanwhile, triple-digit growth at Facebook and MySpace continues. In August, 2005, YouTube's audience was too small to be measured. Now Nielsen reports it attracted 34 million visitors this August—or more than six times as many as MTV.com. Those numbers are closely watched at MySpace, which is why the site is studying a bigger push into video. While far from an assured success, such a move would heighten pressures on content players that lack fancy new distribution deals—and make YouTube's nonexistent stock price jump that much higher. ■

You may wonder why the new equation leaves the stock of Time Warner, long a proponent of synergies in content and distribution (and everywhere else), in the doldrums, even if AOL is no longer part of its title. Two answers: AOL has been around far too long to count as next-generation anything, and for years the smart new-media play was to see where Time Warner was going and run in the other direction. (You may also wonder whether the currently fashionable content-pursuing-distribution play would work in reverse: Would cable giant Comcast Corp.'s run a

Disney in 2004 today be hailed as genius and not result in a hit to the stock, as it did at the time?)

If you're Viacom or Time Warner, you might argue that the market is unduly fond of a new wave of portals, and that MTV.com, AOL, and Viacom's broadband video sites MTV Overdrive and iFilm.com all draw massive audiences. Agreed on first point, but year-over-year

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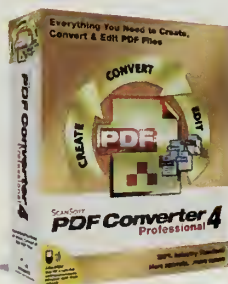
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BY JAMES C. COOPER

# Finally, Relief From the Trade Deficit

es, July was a record—but forces are in place to allow some shrinkage

**U.S. ECONOMY** Don't look now, but there might be some good news on the way to replace the perennial downbeat reports on the U.S. trade deficit. Coming on the heels of July's record gap of \$68 billion, that assertion may sound foolhardy. But several domestic, overseas, and financial market forces are coming together in a way

that is turning the tide, and the shift will directly benefit economic growth.

In fact, when viewed properly, with both imports and exports adjusted for price changes, the deficit already shows signs of stabilizing (chart). That's important, because as this adjusted gap widens, it subtracts from economic growth, as it has done in each of the past 10 years. Just stopping the erosion will eliminate an obstacle to the economy's path, and any shrinkage would be an outright plus for growth.

As the July trade data show, any expectation of automatic improvement would be a pipe dream. Perhaps the biggest obstacle in the way of significant progress on the deficit is the math of U.S. trade. Partly reflecting globalization and the openness of the U.S. economy, price-adjusted imports—or in the economist's vernacular, real imports—have more than doubled in the past decade, while real exports have grown only by a half. That means exports need to grow 50% faster than imports just to keep the deficit from widening further.

Since the end of last year, exports have more than met the challenge. From the fourth quarter of last year through this year's second quarter, real exports of goods and services grew at a 9.4% annual rate, double the 4.7% pace for real imports. In the first quarter, the trade deficit, after taking prices into account, posed no drag at all on growth in real gross domestic product, and it shrank in the second quarter, adding 0.4 percentage points to that quarter's 2.9% advance in real GDP. The July trade numbers suggest the deficit could subtract a bit from third-quarter growth, but the sharp monthly widening is counter to the more favorable price-adjusted trend.

**NO MAIN FACTORS** are behind that improving pattern. First, growth outside the U.S. is picking up even as American growth is easing back a notch. That's one reason real exports have picked up, while real imports have slowed. Oil shows the importance of looking at price-adjusted imports. Crude prices have soared, pushing up the dollar values of both oil imports and total ports, but the actual number of barrels of imported petroleum products is up very little from two years ago. The second big reason for optimism on trade is the

broad decline in the dollar. The slippage began in early 2002 and has resumed this year after a period of strengthening last year. The lower dollar represents a de facto rise in the competitiveness of American products in overseas markets. U.S. exports are now in a position to gain market share abroad, most notably in high-tech capital goods and a broad array of business services, such

as financial and legal. The latest numbers imply they are doing just that.

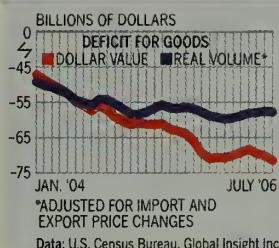
The good news on the dollar is not confined to the major U.S. trading partners (chart, page 32). For two years, the trade-weighted dollar has been declining against a group of 19 smaller, but important, partners. This dollar index, compiled by the Federal Reserve,

includes China and other Asian economies, key Latin American nations, and other countries accounting for about 40% of U.S. trade. Many want to keep their currencies in a narrow band vs. the dollar to maintain their competitiveness. But this index has declined 6.7% from its peak more than two years ago, to the benefit of U.S. exporters. China's small steps toward a more flexible currency has been partly responsible for this trend.

**WHILE THESE TWO PLUSES** will continue to aid the U.S. trade adjustment in the coming year, it is the shifting trends in global demand that will be far more important than changing currency relationships. Stronger foreign demand will give recent U.S. export gains their staying power, because the acceleration in overseas growth has firmer roots than in past upturns.

Unlike other short-lived periods of growth in economies abroad, this pickup is not so much driven by exports, especially to the U.S. This time it is also powered by stronger domestic demand in the individual countries. So even if demand in the U.S. slows a notch as the housing recession works its way through the economy, growth

## TWO VIEWS OF THE TRADE DEFICIT





abroad is not as dependent on the U.S. to lead the global growth parade as it has been over the past several years.

Both Japan and Germany, where private-sector consumption spending and business outlays for capital goods are picking up, are good examples. In both countries, unemployment is down, wages are picking up, and profits are growing. The euro zone's solid 3.6% growth rate in the second-quarter showed a sizable contribution from domestic demand. Over the past year, homegrown spending in both Mexico and Canada, which together take 36% of U.S. exports, is increasing faster than in the U.S., and a similar story is true in many of the Pacific Rim economies.

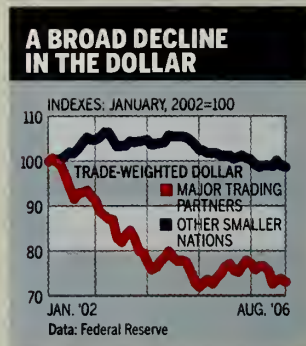
**AGAINST THAT BACKDROP**, U.S. export gains have been broad across all sectors and regions. Capital goods are leading the charge. Strengthening internal demand in overseas economies is boosting capital spending plans of foreign companies. That trend plays right to a U.S. strength. In the first seven months of 2006, price-adjusted exports of capital goods are up more than 14% from the same period in 2005. Big gainers are computers and accessories, semiconductors, telecom gear, electric items, as well as lower-tech machinery and generators.

During the first seven months of 2006, U.S. exports to Canada and Mexico are up about 12% from the same period last year, not adjusted for prices since such data are not available in the monthly trade report. Shipments to the European Union also have risen about 12%, with demand from Pacific Rim countries up 14% and that from

South and Central America up nearly 19%. Exports to OPEC countries are also soaring, up 30%, as petrodollars get recycled back into purchases of U.S. goods.

Looking ahead, a key support under foreign demand continues to be easy global financial conditions. Interest rates outside the U.S. are rising but remain low. In both

Japan and the euro zone, central-bank policy rates adjusted for inflation, are still well below that in the U.S. Relatively narrow risk spreads between the yields on government securities and riskier corporate bonds indicate accommodative borrowing conditions across the globe. And most recently, the sudden dive in oil and energy



prices will further boost corporate and household confidence as well as purchasing power in a broad array of energy-consuming economies.

In each of the four full years of this economic expansion, a widening trade deficit has subtracted anywhere from 0.3 to 0.7 percentage points from overall growth. Clearly the gap is going to remain at a daunting level for some time to come. But 2006 might well be the first year in a decade that trade stops being a drag on economic growth. ■

## PROFIT MARGINS

# Higher Wages Put the Squeeze On Profits

**AFTER MUCH** anecdotal evidence that Corporate America was finding it tougher to maintain its lofty profit margins, more concrete data are confirming the trend. What's more, rising employee compensation costs could cut into margins even further over the coming year.

The pressure on profit margins is occurring across most parts of the economy. A *BusinessWeek* tally of 900 public companies shows sales in the second quarter outside the energy sector jumped a stout 13% from the year before, yet profits grew only 4%, meaning profit margins have eroded.

The financial results are confirmed by government data. Revised second-

quarter figures on productivity and cost show profits per unit of output produced by nonfinancial companies fell in the quarter leaving this measure of profit margins up just 8.4% from the previous year vs. a 16.5% gain in the first quarter. Even in manufacturing, where demand and productivity are strong, profit margins slipped and profits fell, even though sales posted a small increase.

Rapidly rising labor costs are eating into profit margins. Among nonfinancial companies, the labor cost to produce a unit of output rose 2.6% from a year ago. The increase is an even bigger 5% when the financial sector and small businesses are included. At the same time, producers are

unable to fully pass along the higher production costs.

There appears to be little relief on the horizon, according to the result of a September survey of economists by the National Association for Business Economics. Respondents raised their estimates for unit labor cost growth to 2.7% this year and 2.3% in 2007, but trimmed expectations for productivity gains and economic growth. The combination is a big reason why economists see profit growth slowing from 17% in 2006 to 4% next year.

Some businesses may see some of those higher wages return via strong consumer buying. Any further decline in energy prices would also add a measure of relief. But it will not fully offset higher labor costs, as employee compensation accounts for nearly 70% of a company's total operating expenses. ■

—By James Mehring in New

## THE STAT

U.S. corporate profit margins\*

2006  
**7.1**  
2005  
**7.7**  
SECOND QUARTER  
PERCENT

\*Excludes Energy sector  
Data: CompuStat, BusinessWeek



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# The Business Week

## News you need to know

EDITED BY HARRY MAURER

**Is This "The HP Way"?** Hewlett-Packard shuffled its boardroom chairs on Sept. 12 in a bid to cool down a furor over the company's probe into press leaks. HP admitted that outside investigators, led by **Chairman Patricia Dunn**, used a potentially illegal tactic in which they impersonated directors, journalists (including three at *BusinessWeek*), and two employees to obtain personal phone records.



Dunn will cede the chair to **CEO Mark Hurd** but remain on the board (Dunn and Hurd in 2005, photo). **George Keyworth**, fingered as the director who blabbed to the press, will quit, and former longtime HP exec **Richard Hackborn** will become "lead independent director."

But the imbroglio won't die down soon. **California Attorney General Bill Lockyer** said on Sept. 12

that his office has enough evidence to bring charges against people inside and outside HP. Three federal agencies as well as a House subcommittee are circling. And investors? After shrugging off the scandal for days, they sent the stock down nearly 1.5% on Sept. 13, an up day for the market.

**ONLINE** See "Charges on the way at Hewlett-Packard?" [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Oil's Slippery Slope** Crude slid to \$63.97 a barrel on Sept. 13, down from \$77 in early August. Behind the decline: diminishing fears of supply snarls from hurricanes and strife in the Mideast. Futures traders are betting oil will move back up, but some analysts figure it's headed toward \$50.

See "How low can it go?" page 36

**I Want My iTV** Steve Jobs unveiled a slew of new products on Sept. 12 including—in an unusual move for Apple—one that isn't ready yet, dubbed iTV, which is meant

to link Macs wirelessly to TVs. It's Apple's first big play for the couch-potato set, but making it work won't be easy.

See "The iTV: Here's our 2¢," page 45, and **ONLINE** "Apple's Latest Fruits," [www.businessweek.com/go/tb](http://www.businessweek.com/go/tb)

**Dell Delay** Dell, thy name these days is glitch. On Sept. 12, the world's largest computer maker announced it will delay filing second-quarter numbers as it cooperates with a **SEC** accounting probe. Dell noted the "possibility of misstatements" that "may affect the company's previously reported financial results," which in the past year have been less than stellar. It also said the U.S. Attorney for the Southern District of New York has joined the inquiry. The possible accounting snafu is having a domino effect: Dell suspended its stock buyback program and canceled, for the second time this year, its confab with Street analysts.

**Freescale on the Block** Motorola shareholders were understandably derelighted when they got about one share of **Freescale Semiconductor** for every nine shares they owned in parent Motorola at the time of the spin-off. But those who held on are about to have a pleasant payday. When it was launched as an independent company in late 2004, distressed Freescale traded at a measly \$13, 50% below its expected price. Its stock soared, however, as the company rolled out new technologies and gained market share. Now business is so promising that Freescale is discussing an LBO with two buyout groups. Wall Streeters expect a deal to fetch \$16 billion, or \$40 per share, netting shareholders triple their money in just 22 months.

**ONLINE** See "Bidding on Freescale sets off alarm" [www.businessweek.com/go/tb](http://www.businessweek.com/go/tb)

**Options Watch** By now, **Broadcom** must be wishing it had never heard of options. The Irvine (Calif.) chipmaker said on Sept. 8 that it will have to restate results all the way back to 1998, boosting expenses by at least \$1.5 billion to reflect new wrinkles found in its books. Broadcom, which is being probed by the **SEC** and the U.S. Attorney in Los Angeles for alleged backdating of options, estimated in July that it would restate by around \$750 million. The number is the largest yet in the scandal.

**ONLINE** See "Broadcom's options bombshell" [www.businessweek.com/go/tb](http://www.businessweek.com/go/tb)

**Softer SarbOx?** The backlash against the **Sarbanes-Oxley** reforms rolls on. On Sept. 12 a group of executives, accountants, and academics, many with ties to the Bush administration, formed the **Committee on Capital Markets Regulation**. By late November the group, which has no official standing, will be offering up to policymakers its ideas on how to improve SarbOx, presumably by easing its regulatory strictures, which some think are leading global players to steer clear of U.S. public markets. Meanwhile, the **SEC** will tackle a different reform task on Oct. 18, when it will review whether investors should be able to petition corporations for the right to nominate board candidates directly. Today boards themselves select who will run.



**Peltz Wins a Battle** Has Nelson Peltz drawn blood at H.J. Heinz, or just ketchup? The food giant said on Sept. 8 that the hedge fund manager and one of his four running mates have been elected to the board despite a \$14 million campaign by the company to elect its own slate. Peltz, CEO of Triun Fund Management, owns a 5.5% stake and wants Heinz to trim costs. Earlier this year, Peltz got Wendy's to agree to spin off its Tim Horton's doughnut chain and possibly dump its Baja Fresh unit as well. But Heinz isn't capitulating: It plans to enlarge its 10-member board by 2, putting the dissidents in an even smaller minority.

**Pricey Ring Tones** Peter Chernin, president of Rupert Murdoch's News Corp., calls it "the most powerful media company on the Web," and he's looking to extend the franchise. On Sept. 12, News Corp. paid \$188 million for controlling interest in VeriSign's Jamba! ringtones unit. Allied with News Corp.'s cell-phone entertainment company Mozo, it will offer lots of mobile content in the U.S. and 30 other countries. First up besides ringtones: cartoons from X's MySpace site and Simpsons videos from Fox.

**ONLINE** See "A new risk tone for News Corp.," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Circuits in Detroit** Ford's factory workers have absorbed the news of upcoming plant closings and 30,000 job cuts; now it seems white-collar staff will get their turn. The Wall Street Journal said on Sept. 12 that Ford will soon unveil a speeded-up slim-down plan to cut white-collar salary and benefits outlays by a painful 30%. Ford may also adopt a new pricing approach aimed at keeping prices as close to what's on the sticker.

## Exit of the Week

It was a bumpy five-year tenure, and on Sept. 12 came the biggest bump: Bristol-Myers Squibb CEO Peter Dolan (below) got the heave-ho after an external review raised concerns about how Bristol negotiated a patent dispute. The company has been monitored by an ex-federal judge since last year, when it settled charges that it "stuffed the channel"—gave improper sales incentives to drug wholesalers. Now the Justice Dept. is looking into potential violations of antitrust laws in a deal between Bristol and Canadian drugmaker Apotex. The deal fell apart, paving the way for Apotex to launch a generic version of Bristol's blockbuster anti-clotting drug Plavix. (Sales of the generic have been halted, but the move already cost Bristol a bundle.) Bristol General Counsel Richard Willard has also left, and the board named director James Cornelius as interim CEO, leaving Wall Street buzz with takeover speculation. Says Chairman James Robinson III: "We concluded it was time for a change."

See "Why Peter Dolan got the boot," page 98, **ONLINE** and "Patent fight bounces Bristol-Myers CEO," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)



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**OIL OUTLOOK**

# HOW LOW CAN IT GO?

A drop of \$13 a barrel since early August is sweet music to the U.S. economy. The question is how long OPEC will stand pat

**BY STANLEY REED AND PETER COY**

**O**IL PRICES HAVE BEEN dropping like a stone. Their decline from nosebleed heights since early August has been stunning—a plunge of \$13 a barrel, to below \$64 on Sept. 13 on the New York Mercantile Exchange. Behind the fall is a dramatic narrowing of the “fear premium” buyers were paying for oil, as summer worries over supply disruptions from hurricanes and Mideast turmoil have eased. All of a sudden, cheaper oil is giving consumers more spending money and easing inflation.

So how much lower can oil prices go? That’s the big question everywhere from

the Arabian oil sheikdoms to the boardrooms of airlines and automakers. Are we seeing a temporary softening, or have the fundamentals of the oil market started to swing around, bringing an end to the seven-year run-up of prices (page 142)? If so, what’s the impact on the economy?

One thing is certain: Crude oil is a highly volatile commodity. Prices could swing wildly in either direction for myriad reasons—war, weather, the whims of OPEC, you name it. For now, the markets are indicating that high oil prices will stick around for awhile. Futures traders on NYMEX are pricing oil at around \$70 a barrel this winter and through early 2008 and then back to the mid-\$60s by the end of the decade.

Some, though, think prices have more room to fall now. Morgan Stanley economists Eric Chaney and Richard Berg argue that conservation and increased supplies mean prices probably peaked this summer, and they’re forecasting \$50 per barrel at the end of 2007 and \$50 at the end of 2008. Adam Sieminski at Deutsche Bank adds that oil inventories are about as high as they have been at any time in the past five years and that increasing spare production capacity “points to oil in the \$50-per-barrel range.” Don Casturo, head of oil trading at Goldman, Sachs & Co. in London, says oil could fall an additional 5% to 10% before hitting bottom.

Of course, all the experts concede

**>>** Cheaper oil is helping to offset a cooling housing market and may persuade the Fed to hold off raising rates through the fall

## Oil's Abrupt Fall

New York Mercantile Exchange contract for October delivery



their projections could be far off the mark. The Morgan Stanley team offers a range of scenarios all the way from a "hot" \$103 in 2007 to "super cool"—\$43 in 2007 and \$22 in 2008. The hot scenario assumes a big disruption in the supply of oil from Iran, while the super-cool one would result from economic slowdowns in the U.S. and China coupled with a rapid expansion of heavy crude refining capacity.

### FUEL FOR GROWTH

FOR NOW, THOUGH, the trend is clearly down, and that's nothing but good news for the U.S. economy. Motorists save more than \$40 million a day from

each dime decrease in the price of gasoline. Easing prices are helping to offset the chilling effect of the housing slowdown and solidify the likelihood that the U.S. Federal Reserve will keep further rate increases on hold through the fall. The Fed was worried that high energy prices would feed inflation by raising business costs. Now that's looking like less of a problem.

Longer term, it would take a much more significant decrease in the price of oil to make a big difference to the economy. A \$10-a-barrel decrease in the price of crude tends to boost the gross domestic product by about 0.2% in the first year, according to economic



forecaster Global Insight Inc. After three years, the economy is only about 0.5% bigger than it would have been with the higher oil price, the group estimates.

## "OVERSUPPLIED"

STILL, GIVEN THE punishing run-up in prices in recent years, any downward trend is a welcome development. The main beneficiaries of cheaper oil are motorists, airlines, truckers, and other big petroleum-product users such as farmers and chemical companies. For the auto industry, the decline has been too brief to make much difference. Automakers were caught flat-footed by \$3 gasoline, and they realize prices could easily shoot back up, so they're not going to change plans because of the recent drop, says Standard & Poor's equity analyst Efraim Levy. As for drivers, he says, gasoline would have to stay cheaper for a long time before they would warm up to gas-guzzling SUVs and pickups again.

Whether prices go much lower de-

pends a lot on what OPEC does in the coming months. Its power to force up prices by withholding production has been largely irrelevant in recent years. That's because demand was so strong that OPEC members were given the O.K. to produce as much oil as they could, regardless of quotas. Now, though, some slack is appearing in the system.

Pushed and pulled by their own conflicting views of the direction of prices, OPEC oil ministers met on Sept. 11 in Vienna to puzzle out a plan. They agreed that the market was "oversupplied," which ordinarily is code for, "we're cutting production." But the cartel would be uncomfortable with prices of \$70 per barrel or more, worrying that stratospheric prices will cause a backlash among consuming nations and stimulate non-OPEC production, cutting into its market share. So with time

## Already, the Saudis are quietly reducing crude oil sales

thinks is a sensible balance between supply and demand. To minimize political heat from an abrupt, public production cut, the Saudis have already quietly reduced heavy crude sales by about 300,000 barrels per day by overpricing the less desirable grades. Saad Rahim of PFC Energy in Washington thinks the Saudis are mulling another cut of about 1 million barrels per day next year. The Saudis, now producing around 9 million barrels daily, would likely get help in curbing production from Kuwait and the United Arab Emirates. These are all rich countries whose budgets could weather some loss in revenue.

## THE \$60 TRIGGER

FOR OPEC, the tricky thing will be if ministers conclude that bigger cuts are needed. Then, countries such as Iran and Venezuela, which are currently pumping less than their quotas because of technical problems, may be asked to cut back still more—which they may well be reluctant to do. On the other hand, continuing to overproduce would be worse. Ministers remember the precarious financial situation they got into after prices tumbled into the teens in the late 1990s. "I think OPEC will try to defer [to \$60 per barrel] and will likely be successful, and then run into trouble again when we have a recession in the U.S. and GDP slowdown in China," says Deutsche Bank's Sieminski. Yes, \$60 isn't exactly cheap, but sure beats \$80. ■



## Oil Prices: Three Scenarios

### BLOWOUT

The U.S. succeeds in persuading the U.N. to slap sanctions on Iran, stoking up tensions. Iran responds by temporarily suspending exports. Venezuela chips in modest cuts. Prices soar to more than \$100 per barrel.

### DOWNWARD DRIFT

The U.S. economy slows but doesn't go into recession. China cools but not dramatically. No major outages or threats of disruption emerge. Prices hover between \$60 and \$70 per barrel.

### DEEP FREEZE

A global economic slowdown takes hold in 2007 and extends into 2008. At the same time, supplies of crude expand much faster than expected. Prices could go below \$25 per barrel.

Data: Morgan Stanley, BusinessWeek



**CHAVEZ** Fewer Citgo stations stateside, and other U.S. interests are on the block



**OIL**

# CHAVEZ STARTS PUNISHING AMERICA

Venezuela's President is cutting oil exports to the U.S. and selling off assets

**BY CHRISTOPHER PALMERI  
AND GERI SMITH**

**T**HERE WAS A TIME WHEN Pat La Vecchia was glad that the fuel he sold came from friendly Venezuela and not some sheikdom with a history of oil embargoes. "For years, people would come in and say, 'You don't get your oil from the Middle East, right?'" says the owner of Pat's Auto Service, a Citgo station in the Cleveland suburb of Rocky River. That was before Venezuelan president Hugo Chávez came to power in 1998, promoting his anti-U.S. agenda. And it was before Citgo Petroleum Corp., the refining giant owned by the Venezuelan government, informed La Vecchia in July that it was cutting him from its dealer network. Now La Vecchia has no great love for Venezuela or its controversial president. "If the CIA took him out tomorrow," he says, "I wouldn't cry."

Chávez has always marched to his own drummer, spewing anti-U.S. vitriol while hobnobbing with the likes of Fidel Castro.

In the past, the 52-year-old former paratrooper's rants against "American imperialism" seemed more bark than bite. But in recent months he has been making good on his long-standing vow to reduce his ties to the U.S., moves that could slow the slide in gasoline prices. "There's nothing he'd like more than to rub Uncle Sam's nose in the gutter," says Matthew Simmons, founder of a Houston-based oil investment bank that bears his name.

Although Venezuela is still the No. 4 supplier of crude to the U.S., its U.S. exports fell 18% from January to June of this year. And in July the company announced plans to reduce its network of U.S. gas stations by 14%, to 11,200, saying it didn't have enough refining capacity to supply them all. Then, in mid-August, Citgo completed the sale of its interest in one of its largest refineries in Houston to partner Lyondell Chemical Co. for \$2.1

billion. Still on the block are stakes in two large pipelines and Citgo's asphalt business, the largest producer on the U.S. East Coast. "Part of this is the Venezuelan government's desire to loosen economic ties to the U.S.," says Ben Toscanos, an analyst at debt rating agency Standard & Poor's Corp. "They have to make significant investments in their oil industry, and this is one way to fund them."

## CHINA BECKONS

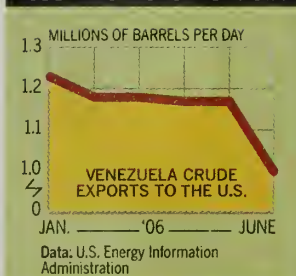
AMERICA'S LOSS MAY turn out to be China's gain. In the last year, Venezuela's oil shipments to China have more than doubled, to 75,000 barrels a day, according to the U.S. Energy Dept. During a recent visit to Beijing, Chávez said shipments to the oil-hungry mainland would hit 200,000 by yearend. Chávez signed contracts with China to build 18 oil tankers and 13 new drilling rigs.

Since gaining power, Chávez has put his own mark on Citgo, which Venezuela began acquiring in 1986 to ensure a market for its crude. He has replaced many American senior managers with Venezuelans. The company, which still owns three major refineries in the U.S., is believed to be quite profitable. It earned \$625 million on sales of \$32 billion in 2004, the last year for which financials were made public. So far this year it has sent \$400 million in dividends back to the Venezuelan government.

Last year, Venezuela considered selling Citgo, but decided against it. Unloading the company in pieces frees up cash for investment, while keeping refineries needed to process Venezuela's high-sulfur crude. "My marching orders are not to sell Citgo [but] to optimize Citgo's businesses," says Felix M. Rodriguez, Citgo's chief executive. "The U.S. has always been an important market for us. It's not our intention to leave."

Few in the oil industry believe Chávez will unload Citgo entirely. It will take years for oil importers such as China to build sophisticated refineries capable of handling heavy Venezuelan crude, notes Enrique Cira, a Caracas-based analyst for Cambridge Energy Research Associates. For that reason, Venezuela may hold onto some Citgo assets for now. But the Venezuelan strongman is unpredictable—and determined to use oil to exert his influence in global affairs. ■

## CARACAS CRUNCH







STOCKS

# TIME FOR TIME WARNER TO UNHOOK THE CABLE

There are obstacles, but CEO Parsons has a spin-off high on his to-do list

BY TOM LOWRY

**A**FTER FOUR YEARS AND four months as CEO of Time Warner, Richard D. Parsons is running out of options to solve his most vexing problem: share-price paralysis. He has settled federal accounting investigations, cut debt, bought back stock, turned AOL into a free service, and Sept. 12 announced the sale of 18 of its magazines. None of these moves has pushed shares above \$19. Now he's readying to play one of his remaining cards: a cable initial public offering. By spinning off part of the media giant's robust cable unit, Parsons is hoping not only to create a new currency to buy more cable but also to juice the parent company—and his own legacy in the process.

Investors like the idea, especially now that cable is popular again (table), having scored successes with their bundles of TV, broadband, and phone services against a diminished threat from satellite and telecoms. Time Warner Cable, subsumed as it is in the sluggish parent company, could unleash its true value with some independence, the thinking goes.

So why not plunge in while the market

is so hot? After all, Parsons first mentioned a possible spin-off four long years ago. But nothing is ever easy at Time Warner, which once again looks to be snakebitten. The problem: The company has been entangled in the messy four-year Adelphia Communications Corp. bankruptcy. Time Warner and Comcast Corp. divvied up Adelphia's well-placed systems in a sale that closed in July, but now creditors are bogged down in squab-

bles, holding up Parsons' cable agenda.

The original plan was to issue shares representing 16% of the cable business to Adelphia creditors as part of Time Warner's deal payment. That would create a ready market for the unit, whose operating profits rose 16% in the first half of the year, to \$1.96 billion. The Adelphia sale is complete, but creditors still disagree over how to split up the proceeds, and they do not appear to be close to a final agreement to exit bankruptcy. Yet if the creditors were to give a thumbs-up to a plan, with a bankruptcy judge's approval, Time Warner Cable could go public as soon as 30 days later.

Wall Street, including media-loving private-equity buyers, would like to see faster action—and a bigger share than a mere 16% of the business. "That percentage may not be enough" to see big gains in the cable stock, or Time Warner's stock, either, says Michael Nathanson, an analyst at Sanford C. Bernstein & Co. "I would like to see them put out more."

## ICAHN CALLING

IT'S NOT HARD to see why investors covet the nation's No. 2 cable operator. If you value Time Warner Cable at \$3,700 per subscriber (using No. 1 Comcast as a benchmark), multiplied by its 13.5 million subs, the unit would be worth \$49.9 billion. Subtract the estimated debt of \$14 billion, and a 16% float has a market value of \$5.4 billion. Parsons insists 16% is the right amount to offer at the outset but has said he would consider selling more later.

With so much at stake, Parsons has also begun to prepare an alternative to the dicey Adelphia plan. Time Warner is in the process of filing a registration plan with the Securities & Exchange Commission to sell shares via a standard IPO. On

this path, it could take three months to win SEC approval. But by then, who knows how Wall Street will feel about cable stocks? Time Warner officials declined to comment, citing restrictions due to the planned share registration.

Meanwhile, billionaire breakup advocate Carl C. Icahn is once again amassing Time Warner shares, putting more pressure on Parsons to act. The magazine sale is already under way. By the time it actually happens, a separate Time Warner Cable stock issue could be just another move in a new, more urgent game plan. ■

## Price Envy

With a partial spin-off of its cable unit stalled, Time Warner is missing out on the Street's new love affair with cable. Check out the gains since mid-April of three big cable distributors.

**COMCAST**  
**22%**  
(to about \$34)

**CABLEVISION**  
**26%**  
(to about \$24)

**CHARTER COMMUNICATIONS**  
**42%**  
(to about \$1.50)

Data: Bloomberg Financial Markets



A close-up portrait of Chris McCann, President of 1-800-Flowers.com, with grey hair and a slight smile, wearing a dark suit and light blue shirt. The background is a soft-focus floral arrangement with yellow and pink flowers.

**CHRIS MCCANN**  
PRESIDENT, 1-800-FLOWERS.COM

**SAS gives 1-800-FLOWERS.COM**

# THE POWER TO KNOW

**how to cultivate brand loyalty through quality customer relationships.**

A pioneer on the Internet, 1-800-FLOWERS.COM is now a leading multichannel retailer with more than 15 million customers. Brand loyalty – rooted in personal, one-to-one customer relationships – has helped the company flourish. And that's where SAS comes in. With SAS' business intelligence and analytic software, 1-800-FLOWERS.COM can quickly understand customer behaviors, target products and offers, and predict results that strengthen its overall CRM strategy. The result? A 15 percent increase in customer retention. To learn more about 1-800-FLOWERS.COM and other SAS success stories that go *Beyond BI*, visit our Web site.

**[www.sas.com/flourish](http://www.sas.com/flourish)**





## INVESTMENT BANKING

# BROKER TO THE NEW-MEDIA STARS

The MySpace deal has made a small firm one of the industry's hottest dealmakers

BY RONALD GROVER

IT WAS MAY, 2005, AND MySpace was in trouble. Despite its runaway success in social networking, New York State Attorney General Eliot Spitzer was investigating its parent company, Intermix Media Inc. Its stock was in free fall, and several potential buyers had walked. Searching for a fix, the bedraggled board invited in Michael J. Montgomery, a Santa Monica investment banker, who came bearing unexpected news: Rupert Murdoch's News Corp. might be interested in buying the company. "We said: 'Are you kidding? News Corp. doesn't want to get into the Internet,'" Richard M. Rosenblatt, at the time Intermix's chief executive officer, recalls telling Montgomery.

Six weeks later, News Corp. agreed to pay \$580 million in cash for Intermix, propelling News Corp. into the Internet stratosphere. It also propelled the fortunes of Montgomery & Co., a little-known investment firm that quickly became one of new media's hottest brokers. Headed by former Walt Disney Treasurer Michael Montgomery and his older brother, James, a former defense industry and technology consultant, the firm has helped sell new-media startups to heavyweights Sony, Viacom, and Yahoo! in the past two years. "Those guys have become the go-to guys after their experience with MySpace," says Blair Harrison, chief executive of iFilm Corp., the user-generated video site that Viacom bought for \$49 million shortly after the News Corp. deal. Harrison says he hired Montgomery after he heard of his MySpace



**MONTGOMERY**  
The former Disney exec has impressive connections

## Matchmaker

Santa Monica-based Montgomery & Co. has helped broker some of the biggest New-Media deals of late (listed by size)

| CLIENT       | BUYER      | PRICE (MILLIONS) | DATE        |
|--------------|------------|------------------|-------------|
| MySpace.com* | News Corp. | \$673            | July, 2005  |
| Rent.com     | eBay       | 415              | Feb., 2005  |
| Musicmatch   | Yahoo      | 160              | Sept., 2004 |
| Grouper.com  | Sony       | 65               | Aug., 2006  |
| iFilm        | Viacom     | 49               | Oct., 2005  |
| Neven Vision | Google     | UNDISCLOSED      | Aug., 2006  |

\*represented MySpace parent company Intermix Media

Data: Montgomery & Co

work. (The firm, which collected \$3 million for the MySpace deal, eventually shared the assignment with San Francisco's Thomas Weisel Partners.)

As with just about everything else on the Net, a new kid on the block is shaking up the traditional players—in this case, media investment powerhouses like Gold-

man Sachs and Allen & Co. Those firms still get plenty of business, but what Montgomery sells is speed, rare in the clubby media world where talks can drag on for months. He set up meetings with prospective buyers for iFilm within 3 hours, says Harrison, and helped strike deal within three weeks of that.

## SEARCHING FOR COOL

MONTGOMERY IS himself a media veteran. As Disney treasurer, the 51-year-old helped arrange film financing deals and rescue package for ailing Euro Disneyland. He left Disney in the early 1990s to help raise \$1 billion in equity toward the launch of DreamWorks Animation SKG Inc.

where he recently joined the board. All the experience has given Montgomery an impressive set of special numbers. At Disney, he was friends with Michael Lynton, now chairman of Sony Pictures Entertainment, which in late August paid \$65 million for Montgomery client Grouper.com, a user-generated video site.

To stay current in the new-media scene, Montgomery has hired a small group of investment bankers in their 30s and younger to scout the Net and hunt for cool blogs. "We go to a lot of conferences, try to get there before the big guys," Montgomery says. The company also holds the annual Montgomery Technology Conference, which this year drew 140 money-seeking startups. "They've taken the right approach," says Atom Entertainment CEO Mika Salmi, who opted not to use an investment bank when he recently sold his video/gaming business to Viacom. "They get in there early and get to know the CEO on a personal level before he needs an investment banker," Salmi says.

Of course, the large media bankers have far deeper pockets. Allen & Co. courts the likes of YouTube Inc. executives at its media glitterfest in Sun Valley, Idaho, and helps finance startups such as Internet-TV service Sling Media and online video service company Brightcove. With a smaller fund, Montgomery recently invested in Specia MEDIA Inc., a fast-growing Irvine, Calif. online advertising company. The trick is to know which sector will be hot next. Right now, Montgomery is betting on content for wireless devices. Then again, so are the big guys. ■

# Is your cholesterol out of whack?

CRESTOR can get your bad cholesterol down. It can also get your good cholesterol up.

High blood pressure and diabetes are among factors that make it even more important to get your bad cholesterol low. But to get your cholesterol right, your doctor may also want your good cholesterol up. And diet and exercise alone may not be enough to lower the bad cholesterol and raise the good.

CRESTOR is a cholesterol medicine that does both.

A 10-mg dose of CRESTOR® (rosuvastatin calcium) along with diet, can lower bad cholesterol, LDL, by up to 52% (vs 7% with placebo). CRESTOR can also raise good cholesterol, HDL, by up to 14% (vs 3% with placebo). Your results may vary.

Down with the bad  Up with the good 

Is CRESTOR right for you? That's a conversation you need to have with your doctor.

#### Important safety information about CRESTOR:

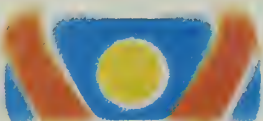
CRESTOR is prescribed along with diet for lowering high cholesterol and has not been determined to prevent heart disease, heart attacks, or strokes. CRESTOR is not right for everyone, including women who are nursing, pregnant, or who may become pregnant, or anyone with liver problems. Your doctor will do blood tests before and during treatment with CRESTOR to monitor your liver function. Unexplained muscle pain and weakness could be a sign of a rare but serious side effect and should be reported to your doctor right away. The 40-mg dose of CRESTOR is only for patients who do not reach goal on 20 mg. Be sure to tell your doctor if you are taking any medications. Side effects occur infrequently and include muscle aches, constipation, weakness, abdominal pain, and nausea. They are usually mild and tend to go away.

Please read the important Product Information about CRESTOR on the adjacent page.

*If you are without prescription coverage and can't afford your medication, AstraZeneca may be able to help.*

CRESTOR helps get your cholesterol right.

800-CRESTOR CRESTOR.COM

  
**CRESTOR**®  
rosuvastatin calcium

AstraZeneca 



**BRIEF SUMMARY:** For full Prescribing Information, see package insert. **INDICATIONS AND USAGE:** CRESTOR is indicated: 1. as an adjunct to diet to reduce elevated total-C, LDL-C, ApoB, nonHDL-C, and TG levels and to increase HDL-C in patients with primary hypercholesterolemia (heterozygous familial and nonfamilial) and mixed dyslipidemia (Fredrickson Type IIa and IIb); 2. as an adjunct to diet for the treatment of patients with elevated serum TG levels (Fredrickson Type IV); 3. to reduce LDL-C, total-C, and ApoB in patients with homozygous familial hypercholesterolemia as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or if such treatments are unavailable. **CONTRAINDICATIONS:** CRESTOR is contraindicated in patients with a known hypersensitivity to any component of this product. Rosuvastatin is contraindicated in patients with active liver disease or with unexplained persistent elevations of serum transaminases (see WARNINGS, Liver Enzymes). **Pregnancy and Lactation:** Atherosclerosis is a chronic process and discontinuation of lipid-lowering drugs during pregnancy should have little impact on the outcome of long-term therapy of primary hypercholesterolemia. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they may cause fetal harm when administered to pregnant women. Therefore, HMG-CoA reductase inhibitors are contraindicated during pregnancy and in nursing mothers. ROSUVASTATIN SHOULD BE ADMINISTERED TO WOMEN OF CHILDBEARING AGE ONLY WHEN SUCH PATIENTS ARE HIGHLY UNLIKELY TO CONCEIVE AND HAVE BEEN INFORMED OF THE POTENTIAL HAZARDS. If the patient becomes pregnant while taking this drug, therapy should be discontinued immediately and the patient apprised of the potential hazard to the fetus. **WARNINGS:** **Liver Enzymes:** HMG-CoA reductase inhibitors, like some other lipid-lowering therapies, have been associated with biochemical abnormalities of liver function. The incidence of persistent elevations (>3 times the upper limit of normal [ULN]) occurring on 2 or more consecutive occasions in serum transaminases in fixed dose studies was 0.4, 0, 0, and 0.1% in patients who received rosuvastatin 5, 10, 20, and 40 mg, respectively. In most cases, the elevations were transient and resolved or improved on continued therapy or after a brief interruption in therapy. There were two cases of jaundice, for which a relationship to rosuvastatin therapy could not be determined, which resolved after discontinuation of therapy. There were no cases of liver failure or irreversible liver disease in these trials. It is recommended that liver function tests be performed before and at 12 weeks following both the initiation of therapy and any elevation of dose, and periodically (e.g., semiannually) thereafter. Liver enzyme changes generally occur in the first 3 months of treatment with rosuvastatin. Patients who develop increased transaminase levels should be monitored until the abnormalities have resolved. Should an increase in ALT or AST of >3 times ULN persist, reduction of dose or withdrawal of rosuvastatin is recommended. Rosuvastatin should be used with caution in patients who consume substantial quantities of alcohol and/or have a history of liver disease (see CLINICAL PHARMACOLOGY, Special Populations, Hepatic Insufficiency). Active liver disease or unexplained persistent transaminase elevations are contraindications to the use of rosuvastatin (see CONTRAINDICATIONS). **Myopathy/Rhabdomyolysis:** Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with rosuvastatin and with other drugs in this class. Uncomplicated myalgia has been reported in rosuvastatin-treated patients (see ADVERSE REACTIONS). Creatine kinase (CK) elevations (>10 times upper limit of normal) occurred in 0.2% to 0.4% of patients taking rosuvastatin at doses up to 40 mg in clinical studies. Treatment-related myopathy, defined as muscle aches or muscle weakness in conjunction with increases in CK values >10 times upper limit of normal, was reported in up to 0.1% of patients taking rosuvastatin doses of up to 40 mg in clinical studies. In clinical trials, the incidence of myopathy and rhabdomyolysis increased at doses of rosuvastatin above the recommended dosage range (5 to 40 mg). In postmarketing experience, effects on skeletal muscle, e.g., uncomplicated myalgia, myopathy and, rarely, rhabdomyolysis have been reported in patients treated with HMG-CoA reductase inhibitors including rosuvastatin. As with other HMG-CoA reductase inhibitors, reports of rhabdomyolysis with rosuvastatin are rare, but higher at the highest marketed dose (40 mg). Factors that may predispose patients to myopathy with HMG-CoA reductase inhibitors include advanced age (>65 years), hypothyroidism, and renal insufficiency. Consequently, 1. Rosuvastatin should be prescribed with caution in patients with predisposing factors for myopathy, such as, renal impairment (see DOSAGE AND ADMINISTRATION), advanced age, and inadequately treated hypothyroidism. 2. Patients should be advised to promptly report unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. Rosuvastatin therapy should be discontinued if markedly elevated CK levels occur or myopathy is diagnosed or suspected. 3. The 40 mg dose of rosuvastatin is reserved only for those patients who have not achieved their LDL-C goal utilizing the 20 mg dose of rosuvastatin once daily (see DOSAGE AND ADMINISTRATION). 4. The risk of myopathy during treatment with rosuvastatin may be increased with concurrent administration of other lipid-lowering therapies or cyclosporine (see CLINICAL PHARMACOLOGY, Drug Interactions, PRECAUTIONS, Drug Interactions, and DOSAGE AND ADMINISTRATION). The benefit of further alterations in lipid levels by the combined use of rosuvastatin with fibrates or niacin should be carefully weighed against the potential risks of this combination. Combination therapy with rosuvastatin and gemfibrozil should generally be avoided. (See DOSAGE AND ADMINISTRATION and PRECAUTIONS, Drug Interactions). 5. The risk of myopathy during treatment with rosuvastatin may be increased in circumstances which increase rosuvastatin drug levels (see CLINICAL PHARMACOLOGY, Special Populations, Race, and Renal Insufficiency, and PRECAUTIONS, General). 6. Rosuvastatin therapy should also be temporarily withheld in any patient with an acute, serious condition suggestive of myopathy or predisposing to the development of renal failure secondary to rhabdomyolysis (e.g., sepsis, hypotension, dehydration, major surgery, trauma, severe metabolic, endocrine, and electrolyte disorders, or uncontrolled seizures). **PRECAUTIONS:** **General:** Before instituting therapy with rosuvastatin, an attempt should be made to control hypercholesterolemia with appropriate diet and exercise, weight reduction in obese patients, and treatment of underlying medical problems (see INDICATIONS AND USAGE). Administration of rosuvastatin 20 mg to patients with severe renal impairment ( $CL_{CR} < 30 \text{ mL/min/1.73 m}^2$ ) resulted in a 3-fold increase in plasma concentrations of rosuvastatin compared with healthy volunteers (see WARNINGS, Myopathy/Rhabdomyolysis and DOSAGE AND ADMINISTRATION). The result of a large pharmacokinetic study conducted in the US demonstrated an approximate 2-fold elevation in median exposure in Asian subjects (having either Filipino, Chinese, Japanese, Korean, Vietnamese or Asian-Indian origin) compared with a Caucasian control group. This increase should be considered when making rosuvastatin dosing decisions for Asian patients (see WARNINGS, Myopathy/Rhabdomyolysis, CLINICAL PHARMACOLOGY, Special Populations, Race, and DOSAGE AND ADMINISTRATION). **Information for Patients:** Patients should be advised to report promptly unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. When taking rosuvastatin with an aluminum and magnesium hydroxide combination antacid, the antacid should be taken at least 2 hours after rosuvastatin administration (see CLINICAL PHARMACOLOGY, Drug Interactions). **Laboratory Tests:** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg, when compared to lower doses of rosuvastatin or comparator statins, though it was generally transient and was not associated with worsening renal function. Although the clinical significance of this finding is unknown, a dose reduction should be considered for patients on rosuvastatin 40 mg therapy with unexplained persistent proteinuria during routine urinalysis testing. **Drug Interactions:** **Cyclosporine:** When rosuvastatin 10 mg was coadministered with cyclosporine in cardiac transplant patients, rosuvastatin mean  $C_{max}$  and mean AUC were increased 11-fold and 7-fold, respectively, compared with healthy volunteers. These increases are considered to be clinically significant and require special consideration in the dosing of rosuvastatin to patients taking concomitant cyclosporine (see WARNINGS, Myopathy/Rhabdomyolysis,

and DOSAGE AND ADMINISTRATION). **Warfarin:** Coadministration of rosuvastatin to patients on stable warfarin therapy resulted in clinically significant rises in INR (>4, baseline 2-3). In patients taking coumatin anticoagulants and rosuvastatin concomitantly, INR should be determined before starting rosuvastatin and frequently enough during early therapy to ensure that no significant alteration of INR occurs. Once a stable INR time has been documented, INR can be monitored at the intervals usually recommended for patients on coumatin anticoagulants. If the dose of rosuvastatin is changed, the same procedure should be repeated. Rosuvastatin therapy has not been associated with bleeding or with changes in INR in patients not taking anticoagulants. **Gemfibrozil:** Coadministration of a single rosuvastatin dose to healthy volunteers on gemfibrozil (600 mg twice daily) resulted in a 2.2- and 1.9-fold, respectively, increase in mean  $C_{max}$  and mean AUC of rosuvastatin (see DOSAGE AND ADMINISTRATION). **Endocrine Function:** Although clinical studies have shown that rosuvastatin alone does not reduce basal plasma cortisol concentration or impair adrenal reserve, caution should be exercised if any HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered concomitantly with drugs that may decrease the levels or activity of endogenous steroid hormones such as ketoneconazole, spiroclonazole, and cimetidine. **CNS Toxicity:** CNS vascular lesions, characterized by perivascular hemorrhages, edema, and mononuclear cell infiltration of perivascular spaces, have been observed in dogs treated with several other members of this drug class. A chemically similar drug in this class produced dose-dependent optic nerve degeneration (Wallerian degeneration of retinogeniculate fibers) in dogs, at a dose that produced plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose. Edema, hemorrhage, and partial necrosis in the interstitium of the choroid plexus was observed in a female dog sacrificed moribund at day 24 at 90 mg/kg/day by oral gavage (systemic exposures 100 times the human exposure at 40 mg/kg/day based on AUC comparisons). Corneal opacity was seen in dogs treated for 52 weeks at 6 mg/kg/day by oral gavage (systemic exposures 20 times the human exposure at 40 mg/kg/day based on AUC comparisons). Cataracts were seen in dogs treated for 12 weeks by oral gavage at 30 mg/kg/day (systemic exposures 60 times the human exposure at 40 mg/kg/day based on AUC comparisons). Retinal dysplasia and retinal loss were seen in dogs treated for 4 weeks by oral gavage at 90 mg/kg/day (systemic exposures 100 times the human exposure at 40 mg/kg/day based on AUC). Ooses  $\leq 30 \text{ mg/kg/day}$  (systemic exposures  $\leq 60$  times the human exposure at 40 mg/kg/day based on AUC comparisons) following treatment up to one year, did not reveal retinal findings. **Carcinogenesis, Mutagenesis, Impairment of Fertility:** In a 104-week carcinogenicity study in rats at dose levels of 2, 20, 60, or 80 mg/kg/day by oral gavage, the incidence of uterine stromal polyps was significantly increased in females at

patients in placebo-controlled clinical studies of rosuvastatin are shown in Table 1; discontinuations due to adverse events in these studies of up to 12 weeks duration occurred in 3% of patients on rosuvastatin and 5% on placebo.

Table 1. Adverse Events in Placebo-Controlled Studies

| Adverse event           | Rosuvastatin<br>N=744 | Placebo<br>N=382 |
|-------------------------|-----------------------|------------------|
| Pharyngitis             | 9.0                   | 7.6              |
| Headache                | 5.5                   | 5.0              |
| Diarrhea                | 3.4                   | 2.9              |
| Dyspepsia               | 3.4                   | 3.1              |
| Nausea                  | 3.4                   | 3.1              |
| Myalgia                 | 2.8                   | 1.3              |
| Asthenia                | 2.7                   | 2.6              |
| Back pain               | 2.6                   | 2.4              |
| Flu syndrome            | 2.3                   | 1.8              |
| Urinary tract infection | 2.3                   | 1.6              |
| Rhinitis                | 2.2                   | 2.1              |
| Sinusitis               | 2.0                   | 1.8              |

In addition, the following adverse events were reported, regardless of causality assessment, in  $\geq 1\%$  of 10,275 patients treated with rosuvastatin in clinical studies. The events in *italics* occurred in  $\geq 2\%$  of these patients. **Body as a Whole:** Abdominal pain, accidental injury, chest pain, infection, pain, pelvic pain, and neck pain. **Cardiovascular System:** Hypertension, angina pectoris, vasodilation, and palpitation. **Digestive System:** Constipation, gastroenteritis, vomiting, flatulence, periodontal abscess, and gastritis. **Endocrine:** Diabetes mellitus. **Hemic and Lymphatic System:** Anemia and ecchymosis. **Metabolic and Nutritional Disorders:** Peripheral edema. **Musculoskeletal System:** Arthritis, arthralgia, and pathological fracture. **Nervous System:** Dizziness, insomnia, hyperreflexia, paresthesia, depression, anxiety, vertigo, and neuralgia. **Respiratory System:** Bronchitis, cough increased, dyspnea, pneumonia, and asthma. **Skin Appendages:** Rash and pruritus. **Laboratory Abnormalities:** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg, when compared to lower doses of rosuvastatin or comparator statins, though it was generally transient and was not associated with worsening renal function. (See PRECAUTIONS, Laboratory Tests). Other abnormal laboratory values reported were elevated creatinine phosphokinase, transaminases, hyperglycemia, glutamyl transpeptidase, alkaline phosphatase, bilirubin, and thyro function abnormalities. Other adverse events reported less frequently than 1% in the rosuvastatin clinical study program, regardless of causality assessment, included arrhythmia, hepatitis, hyposensitivity reactions (i.e., face edema, thrombocytopenia, leukopenia, vesiculobullous rash, urticaria, and angioedema), kidney failure, syncope, myasthenia, myositis, pancreatitis, photosensitivity reaction, myopathy, and rhabdomyolysis. **Postmarketing Experience:** In addition to the events reported above, as with other drugs in this class, the following event has been reported during post-marketing experience with CRESTOR, regardless of causality assessment: very rare cases of jaundice. **OVERDOSAGE:** There is no specific treatment in the event of overdose. In the event of overdose, the patient should be treated symptomatically and supportive measures instituted as required. Hemodialysis does not significantly enhance clearance of rosuvastatin. **DOSAGE AND ADMINISTRATION:** The patient should be placed on a standard cholesterol-lowering diet before receiving CRESTOR and should continue on this diet during treatment. CRESTOR can be administered as a single dose at any time of day, with or without food. **Hypercholesterolemia (Heterozygous Familial and Nonfamilial) or Mixed Dyslipidemia (Fredrickson Type IIa and IIb):** The dose range for CRESTOR is 5 to 40 mg once daily. Therapy with CRESTOR should be individualized according to goal therapy and response. The usual recommended starting dose of CRESTOR is 10 mg once daily. However, initiation of therapy with 5 mg once daily should be considered for patients requiring aggressive LDL-C reductions, who have predisposing factors for myopathy, and as noted below special populations such as patients taking cyclosporine, Asian patients, and patients with severe renal insufficiency (see CLINICAL PHARMACOLOGY, Race, and Renal Insufficiency, and Drug Interactions). For patients with marked hypercholesterolemia (LDL-C >190 mg/dL) and aggressive lipid targets, a 20-mg starting dose may be considered. After initiation and/or upon titration CRESTOR, lipid levels should be analyzed within 2 to 4 weeks and dosage adjusted according to the 40-mg dose of CRESTOR is reserved only for those patients who have not achieved their LDL-C goal utilizing the 20 mg dose of CRESTOR once daily (see WARNINGS, Myopathy/Rhabdomyolysis). When initiating statin therapy or switching from another statin therapy, appropriate CRESTOR starting dose should first be utilized, and only then titrated according to the patient's individualized goal of therapy. **Homozygous Familial Hypercholesterolemia:** The recommended starting dose of CRESTOR is 20 mg once daily in patients with homozygous FH. The maximum recommended daily dose is 40 mg. CRESTOR should be used in these patients as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or if such treatments are unavailable. Response to therapy should be estimated from pre-apheresis LDL levels. **Dosage in Asian Patients:** Initiation of CRESTOR therapy with 5 mg once daily should be considered for Asian patients. The potential for increased systemic exposures relative to Caucasians is relevant when considering escalation of dose in cases where hypercholesterolemia is not adequately controlled at doses of 5, 10, or 20 mg once daily. (See WARNINGS, Myopathy/Rhabdomyolysis, CLINICAL PHARMACOLOGY, Special Populations, Race, and PRECAUTIONS, General). **Dosage in Patients Taking Cyclosporine:** In patients taking cyclosporine, therapy should be limited to CRESTOR 5 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Concomitant Lipid-Lowering Therapy:** The effect of CRESTOR on LDL-C and total-C may be enhanced in combination with a bile acid binding resin. If CRESTOR is used in combination with gemfibrozil, the dose of CRESTOR should be limited to 10 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Dosage in Patients With Renal Insufficiency:** No modification of dosage is necessary for patients with moderate renal insufficiency. For patients with severe renal impairment ( $CL_{CR} < 30 \text{ mL/1.73 m}^2$ ) not on hemodialysis, dosing of CRESTOR should be started at 5 mg once daily and increased 10 mg once daily (see PRECAUTIONS, General, and CLINICAL PHARMACOLOGY, Special Populations, Renal Insufficiency). **NOTE:** This summary provides important information about CRESTOR. For more information, please ask your doctor or health care professional about the full Prescribing Information discuss it with them. **Rx only** CRESTOR is a trademark of the AstraZeneca group of companies. © AstraZeneca 2005 Licensed from SHIONOGI & CO., LTD., Osaka, Japan Manufactured for AstraZeneca Pharmaceuticals LP Wilmington, DE 19850 By: IPR Pharmaceuticals, Inc. Carolina, PR 00984 PCC 630302 3004-01 3128-00 Rev 08/05 242155

## CRESTOR<sup>®</sup> rosuvastatin calcium

80 mg/kg/day at systemic exposure 20 times the human exposure at 40 mg/kg/day based on AUC. Increased incidence of polyps was not seen at lower doses. In a 107-week carcinogenicity study in mice given 10, 60, 200 mg/kg/day by oral gavage, an increased incidence of hepatocellular adenoma/carcinoma was observed at 200 mg/kg/day at systemic exposures 20 times human exposure at 40 mg/kg/day based on AUC. An increased incidence of hepatocellular tumors was not seen at lower doses. Rosuvastatin was not mutagenic or clastogenic with or without metabolic activation in the Ames test with *Salmonella typhimurium* and *Escherichia coli*, the mouse lymphoma assay, and the chromosomal aberration assay in Chinese hamster lung cells. Rosuvastatin was negative in the *in vivo* micronucleus test. In rat fertility studies with oral gavage doses of 5, 15, 50 mg/kg/day, males were treated for 9 weeks prior to and throughout mating and females were treated 2 weeks prior to mating and throughout mating until gestation day 7. No adverse effect on fertility was observed at 50 mg/kg/day (systemic exposures up to 10 times human exposure at 40 mg/kg/day based on AUC comparisons). In testicles of dogs treated with rosuvastatin at 30 mg/kg/day for one month, spermatogenic giant cells were seen. Spermatogenic giant cells were observed in monkeys after 6-month treatment at 30 mg/kg/day in addition to vacuolization of seminiferous tubular epithelium. Exposures in the dog were 20 times and in the monkey 10 times human exposure at 40 mg/kg/day based on body surface area comparisons. Similar findings have been seen with other drugs in this class. **Pregnancy:** **Pregnancy Category X** (see CONTRAINDICATIONS). Rosuvastatin may cause fetal harm when administered to a pregnant woman. Rosuvastatin is contraindicated in women who are or may become pregnant. Safety in pregnant women has not been established. There are no adequate and well-controlled studies of rosuvastatin in pregnant women. Rosuvastatin crosses the placenta and is found in fetal tissue and amniotic fluid at 3% and 20%, respectively, of the maternal plasma concentration following a single 25 mg oral gavage dose on gestation day 16 in rats. A higher fetal tissue distribution (25% maternal plasma concentration) was observed in rabbits after a single oral gavage dose of 1 mg/kg on gestation day 18. If this drug is administered to a woman with reproductive potential, the patient should be apprised of the potential hazard to a fetus. In female rats given oral gavage doses of 5, 15, 50 mg/kg/day rosuvastatin before mating and continuing through day 7 postcoitus (systemic exposures 10 times human exposure at 40 mg/kg/day based on AUC comparisons). In pregnant rats given oral gavage doses of 2, 20, 50 mg/kg/day from gestation day 7 through lactation day 21 (weaning), decreased pup survival occurred in groups given 50 mg/kg/day, systemic exposures  $\geq 12$  times human exposure at 40 mg/kg/day based on body surface area comparisons. In pregnant rabbits given oral gavage doses of 0.3, 1, 3, 10 mg/kg/day from gestation day 6 to lactation day 18 (weaning), exposures equivalent to human exposure at 40 mg/kg/day based on body surface area comparisons, decreased fetal viability and maternal mortality was observed. Rosuvastatin was not teratogenic in rats at  $\leq 25 \text{ mg/kg/day}$  or in rabbits  $\leq 3 \text{ mg/kg/day}$  (systemic exposures equivalent to human exposure at 40 mg/kg/day based on AUC or body surface comparison, respectively). **Nursing Mothers:** It is not known whether rosuvastatin is excreted in human milk. Studies in lactating rats have demonstrated that rosuvastatin is secreted into breast milk at levels 3 times higher than that obtained in the plasma following oral gavage dosing. Because many drugs are excreted in human milk and because of the potential for serious adverse reactions in nursing infants from rosuvastatin, a decision should be made whether to discontinue nursing or administration of rosuvastatin taking into account the importance of the drug to the lactating woman. **Pediatric Use:** The safety and effectiveness in pediatric patients have not been established. Treatment experience with rosuvastatin in a pediatric population is limited to 8 patients with homozygous FH. None of these patients was below 8 years of age. **Geriatric Use:** Of the 10,275 patients in clinical studies with rosuvastatin, 3,159 (31%) were 65 years and older, and 698 (6.8%) were 75 years and older. The overall frequency of adverse events and types of adverse events were similar in patients above and below 65 years of age. (See WARNINGS, Myopathy/Rhabdomyolysis). The efficacy of rosuvastatin in the geriatric population ( $\geq 65$  years of age) was comparable to the efficacy observed in the non-elderly. **ADVERSE REACTIONS:** Rosuvastatin is generally well tolerated. Adverse reactions have usually been mild and transient. In clinical studies of 10,275 patients, 3.7% were discontinued due to adverse experiences attributable to rosuvastatin. The most frequent adverse events thought to be related to rosuvastatin were myalgia, constipation, asthenia, abdominal pain, and nausea. **Clinical Adverse Experiences:** Adverse experiences, regardless of causality assessment, reported in  $\geq 2\%$  of



IZMOS

# THE iTV: HERE'S OUR 2¢

A couple of savvy critics kick around Apple's newest offering

**O**N SEPT. 12, APPLE COMPUTER CEO Steve Jobs took the unusual step of previewing new hardware months before it will ship. Dubbed iTV, it's a \$299 gadget that can wirelessly transfer movies, music, and other digital media from the iTunes library on your PC or Mac to a high-definition TV. Fans say iTV could be the missing link that finally brings downloaded entertainment straight to your TV. Critics say Jobs displayed a half-baked product to preempt the competition. We eavesdropped on an exchange between two of our guys who sort things out for a living, Tech & You columnist Steve Wildstrom and consumer electronics correspondent Cliff Edwards:

**Steve:** You were there when Steve Jobs previewed iTV. What did you think?

**Cliff:** My take is, it could be great—with a lot of “ifs.” Apple now has powerful Intel chips and iTunes, the best software for organizing digital entertainment. The interface for the new iTV is a remote control and on-screen graphics that a grandmother could understand, and it works with both Windows and Mac computers. Simply put, if Apple can deliver what it demo'd, it trumps every offering out there.

**Steve:** Forgive my skepticism, but this is all on the come. It could be really important, assuming it delivers what is promised, works simply, meets Hollywood's demands for content protection, etc. But the devil is in the details. Devices of this sort are called digital media adapters, and I think I've tried every one of them. I have yet to see one that I could buy, or even use if it was given to me.

**Cliff:** People might call this vaporware because it was announced so far ahead of when it will be sold. Personally, I think Apple did that to blunt criticism that its new movie-download service does not let you burn DVDs or do anything but watch on a PC or tiny iPod screen. Apple hopes you come away from this event with the impression that you can buy



**VAPORWARE?** Some snipe that Jobs previewed iTV just to preempt the competition

movies to your heart's content and, in time, enjoy them on TV.

**Steve:** The real issue is how you get the content from the PC or Mac running iTunes to the iTV, which is off somewhere else in your house. Apple would like you to just connect this \$299 box to your big digital television and you could stream the movies you have downloaded from your PC or Mac. But it's a huge question whether you can connect this stuff wirelessly.

**Cliff:** True enough. The box does have an Ethernet jack for the best connectivity, but Apple seems to be depending on 802.11n, a next-generation Wi-Fi standard. And let's say that you bought this device a few months from now. It's not even clear whether you could start watching movies right away. Jobs says it will take 30 minutes to download a movie if you have a 5-megabyte

Internet connection. That ignores the fact that most DSL customers get nowhere near that. And Apple right now is only promising “near-DVD quality” for movie downloads. You can bet purists will notice the difference when watching on a pricey big-screen HDTV.

**Steve:** The claim that you can start playing an iTV movie five minutes after you start downloading it from the Net might be true—in Korea, but not on any U.S. broadband system I know of. I think 802.11n, when it's available, will work for standard-definition video. But high-definition is what this game is about, and nothing works for HD. The bandwidth requirements are huge. Worse, Hollywood's relentless demand for content protection has created systems that make it difficult to connect digital HD devices with cables and all but impossible to do so wirelessly. Apple clearly intends to do HD because it demonstrated HD content, but I'm mystified as to how.

I've learned not to underestimate Apple, but the laws of physics have to be dealt with—even in the reality-distortion field that makes you believe everything Steve Jobs says while he's on that stage.





## PENSION WATCH

# HOPPED UP ON HEDGE FUNDS

Pension plans like Indiana's are taking bigger risks—with taxpayers' money

BY ADRIENNE CARTER

**P**UBLIC PENSION FUNDS have taken heat lately for a slew of problems. From New York to Ohio, critics have lambasted them for inadequate disclosure, mismanagement, and promises to retirees that could leave taxpayers holding the bag. So it seems an odd time for a smallish fund to plunge deeply into hedge funds and other risky so-called alternative investments.

Yet that's precisely what the Indiana Public Employees' Retirement Fund wants to do. The board of the \$14.6 billion pension fund, which oversees the retirement of 220,000 state employees, voted in late August to bump up its alternative investment target to 15% from 5%. It also broadened the menu to include not only private equity and real estate but also hedge funds and commodities. And Indiana said it would cut its safest holdings, bonds, from a target of 30% to 20%. All this from a state that began investing in stocks only 10 years ago.

Indiana is following the lead of other state and local pension funds trying to catch up with bigger funds such as the \$210 billion California Public Employees' Retirement System, which has been sinking money into alternative investments for years. The goal is the same for all: to diversify portfolios and generate higher returns. New Jersey's \$74 billion pension funds, for example, moved last year to devote 13% to alternative investments, from zero before, while the Philadelphia pension system wants to nearly double its allocation to 11%. The average public fund has around 8%.

But there's a key difference: New Jersey and Philadelphia are underfunded and feeling pressure to juice returns. Indiana is nearly fully funded. State pension fund director David J. Adams says his board set the 15% target after a routine asset allocation review. He says he expects annual returns of 8.1% from the new mix, compared with the current target of 7.25%. The extra gains, he says, could reduce the amount taxpayers must kick in. Sounds simple, in theory.

Is jumping in right now prudent, though? Private equity funds, hedge funds, commodities, and real estate have all enjoyed strong returns in recent years. The

best investments are made when there's blood in the streets, not confetti.

Of course, pension funds aren't market timers; their investment horizons are long. And a central tenet of investment theory is that broad diversification increases returns and lowers overall volatility. Asset allocation specialists barely bat an eye at Indiana's decision. "The number '15' by itself is not an unreasonable allocation," says Jack M. Marco, chairman of Marco Consulting Group, which advises pension funds on such matters.

## OUTSIDE DABBLING

**BUT WHAT MIGHT** Indiana's 15% consist of? It's an important question for a state that currently invests less than 1% in alternative investments—far below its present allocation—and has only recently begun to dabble outside the comfy confines of bonds. Adams has done well since he was named to the top spot 18 months ago. His fund reaped a 10.4% gain in the 12 months ended in June, thanks to stakes in

alternative assets like the private-equity fund Lincoln Capital and an Indiana-based real estate fund, both of which combined to return 21% last year. But those investments total only \$88 million. Indiana is now proposing to invest \$2 billion and reach that goal within six years.

Choosing a top-flight private equity or hedge fund isn't easy. There was a 10-percentage-point performance gap between top-tier private-equity firms and those in the median range, according to Thomson Venture Economics. And Indiana

might not be able to get into the fund truly covets. Top performers can be picked out with so much money pouring in.

Consider the Arizona Public Safety Personnel Retirement System, which manages \$6.2 billion for the states' firefighters, police, and the like. It began looking at private equity just over a year ago. But even though the fund can devote 5% to 6% of its money in such investments, it has less than 2% in total. "We're new to the space, so it's more difficult to get access to the better funds," says the pension's chief investment officer, James Nielsen. But given the current environment in alternative investments, any resistance Indiana meets from funds might be a blessing. ■

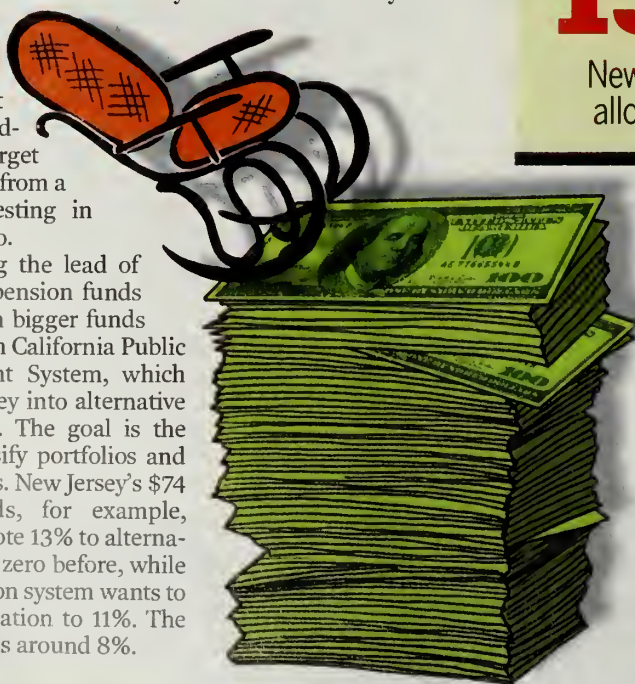
## THE STAT

**0.6%**

Current allocation to alternative investments

**15%**

New target allocation



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should ever get into an accident that's your fault, insurance could protect a lot more than your vehicle. Ever heard the phrase, "I'll sue you for everything you own"?

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## TOYLAND

# MATTEL NEEDS A KNOCK-ME-OUT ELMO

Will his new incarnation make the Street love the toymaker again?

BY CHRISTOPHER PALMERI

IT'S THE BEST-KEPT SECRET IN toyland. On Sept. 19, Mattel Inc. will debut the latest version of its popular Elmo toy. In the past, the furry red *Sesame Street* character has giggled when tickled, danced the hokey pokey, and performed the limbo in a Hawaiian shirt. This year, however, Mattel is refusing to reveal Elmo's latest trick. To build buzz for the toy's 10-year anniversary, retailers won't receive boxes of the new \$40 Elmos until the night before they go on sale. Some stores have even installed countdown calendars, tearing off the days until T.M.X. Elmo is unveiled on *Good Morning America*. "Innovation and marketing, it's exactly what the industry needs," says Gerald L. Storch, Chairman and CEO of Toys 'R' Us Inc.

It will take more than an Elmo makeover to get Wall Street tickled about Mattel again. Toymakers' sales have been flat for much of this decade as kids increasingly shun toy cars and stuffed animals in favor of video games, computers,

and digital music devices. The industry's largest player at \$5.1 billion in sales, Mattel saw its earnings fall 27% last year, to \$417 million. Beyond competition from electronic gadgets, its flagship Barbie brand has come under attack from the saucy Bratz doll line, made by rival MGA Entertainment Inc. In recognition of the company's woes, Robert A. Eckert, Mattel's CEO since 2000, shook up his senior management team last October, promoting 59-year-old Neil B. Friedman, the highly regarded president of the company's Fisher-Price preschool unit, to supervise its major brands.

## RUMBLE IN THE AISLE

ELMO IS FRIEDMAN'S baby. He launched the first version, Tickle Me Elmo, while head of the preschool division of Tyco Toys in 1996. Tickle Me became an industry phenomenon. Parents stampeded stores to get them. Some were offered secondhand at prices as high as \$1,500. Mattel acquired Tyco the following year, and Friedman went on to marry one of Elmo's designers. (His wife, Amanda, no longer works for the company.)

But the industry hasn't seen a breakaway hit like that since the fuzzy Furby doll craze in 1998. Toymakers and retailers love frenzy-inducing items because they bring more traffic to stores. "When there are hot toys, the consumer will shop the toy aisle more," Friedman says. "There's a halo effect across everything."

Mattel is helping to fuel the potential Elmo frenzy by manufacturing fewer of the toys than it normally would, says Jim Silver, co-publisher of *Toy Wishes*, an industry trade publication. He esti-

## Less Cuddling

Sales of traditional toys have been slumped in the face of electronic competition

|                                      | 2005 SALES     | CHANGE OVER 2004 |
|--------------------------------------|----------------|------------------|
| Stuffed animals and other plush toys | \$1.3 billion  | -14%             |
| Video Games                          | \$10.5 billion | +5.8%            |

Data: The NPD Group Inc.

mates that Mattel is making about one-third fewer than its usual run of about 10 million Elmos. That has retailers chomping at the bit. "I have never seen this item," says Robert Weinberg, senior vice president of merchandising and product development at retailer KB Toys Inc. "I really want a lot more."

Mattel should have other hits to look forward to this Christmas. A line of electronics for toddlers is generating a lot of buzz. This includes the \$70 Kid-Tough Digital Camera, made of rubber so kids can drop it. It features two viewfinders because very young children can't always close one eye. "The digital camera is already red-hot," Friedman says.

Because of the 12- to 18-month lead times in toy development, however, industry analysts say Friedman's real opportunity to turn around Mattel's finances won't come until next year. Friedman concedes that the company's sales in the industry have not always done a good job of creating what he calls the "wow factor" in toys. In the past, he says, Barbie wound up being "just a doll in a box." That's why a new bridal-themed Barbie line for next spring will include a camera that plays the wedding march, ring bells, and dolls that turn into flower girls. "A toy has got to be fun," Friedman says. And it's got to make registers ring. ■

### FRIEDMAN

Mattel has been short on the "wow factor"







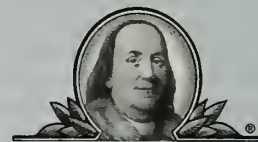
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| 3-Year                             | 12.33% | 0.72               |
| 5-Year                             | 5.65%  | 0.60               |
| 10-Year                            | 10.38% | 0.60               |

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<sup>†</sup> Beta is a measure of a fund's volatility relative to the S&P 500 Index. A beta lower than 1.00 indicates volatility lower than the market's. Source: Thomson Financial 6/30/06.



## TURNAROUND ARTISTS

# GRADING GHOSN

He worked a miracle at Nissan. But GM and Ford would be an order of magnitude tougher

BY DAVID WELCH

**C**ARLOS GHOSN IS THE auto industry's rock star. Kirk Kerkorian thinks the globe-trotting, job-juggling chief executive of Renault-Nissan is brilliant enough to help fix General Motors Corp. in his spare time. And if the proposed alliance between GM and Renault-Nissan doesn't happen, Ghosn might still strike a deal with Ford Motor Co. "We are concentrating on the present talks," Ghosn said in his office in the gritty Paris suburb of Boulogne. "A North American partner would make sense."

As Ghosn and GM near their early October deadline for coming up with an alliance or walking away, all of the attention raises a weighty question: Does Ghosn really deserve his reputation as a miracle worker? There's no denying that Ghosn performed a remarkable feat at Nissan Motor Co., reviving the troubled Japanese carmaker faster than anybody dreamed possible. "Turnaround on the scale of [Nissan's] has hardly been equaled in Western capitalism, and especially not across cultures," says Piero Morosini, professor of strategy at the IMD business school in Lausanne, Switzerland.

If Ghosn were to cut a deal with GM or Ford and work his magic, he would join the ranks of industry legends such as Alfred Sloan, Lee Iacocca, and Eiji Toyoda. But truly changing the way big American automakers do business would be harder than anything Ghosn has accomplished so far. Some of his fix-it moves in Japan would be tough to replicate in the U.S., and recent stumbles call into question whether his turnaround has staying power. "He's played the first inning," says James N. Hall, vice-president of AutoPacific Inc., a Tustin (Calif.) forecasting firm. "Now he has to back up what he's done and develop some

vehicles that people really want to buy."

While Ghosn is a turnaround genius, his long-term record as an operating executive is mixed. Consider the recent performance of Nissan, where he built his reputation. After Ghosn's arrival in 1999, the automaker boosted U.S. sales by 40% over five years, to more than 1.1 million vehicles annually in 2005. But this year, growth has stalled. Through August, sales are down 5% in the U.S. and 13% in Japan. Sales and

### Report Card

He's a turnaround genius. But his record as an operating executive is mixed.

#### A+ RESTRUCTURING:

Ghosn transformed Nissan from losing \$6 billion in 1999 to earning at least \$4 billion every year since 2003. In the same period, he paid off \$12 billion in debt and built a \$3.2 billion cash hoard.

#### B PRODUCT DEVELOPMENT:

The Nissan Murano and many Infinitis were hits, but pickup trucks and large SUVs haven't done much. Wins like the Altima sedan and the \$6,500 Renault Logan subcompact were mostly developed on someone else's watch.

#### C QUALITY:

Nissan's quality remains below average in the U.S. Ghosn dispatched teams of engineers to the newish Canton (Miss.) plant but hasn't been able to fix all the problems.

#### B SALES AND MARKET SHARE:

Nissan's U.S. sales are up over 40% in the U.S., to 1.1 million vehicles a year, but market share is falling this year. The slump is even worse in Japan.

margins are also down at Renault.

The main reason Nissan's early performance in the U.S. fizzled is that it failed to gain significant market share after launching a raft of new vehicles such as large pickup trucks and sport-utility vehicles. Nissan entered those segments during Ghosn's tenure, and since it had never sold such vehicles before, sales growth looked great. But the 85,000 Titan pickup trucks and 40,000 Armada SUVs Nissan sells annually are only one-tenth the number sold by GM. And the styling on Nissan's biggest success, the Altima sedan, was largely complete when Ghosn signed on. He admits that Nissan's current malaise stems from the fact that he didn't keep up the pace with new models, but he says he has the problem licked. "The product drought at Nissan is coming to an end," Ghosn says. "It will never happen again. We're out of the desert."

Questions have also arisen about whether the CEO cut too many corners to gain U.S. market share. In his eagerness to reinvestigate Nissan, Ghosn challenged workers to launch a parade of new vehicles in his first four years at the company. Three—the Titan pickup, Armada and Quest minivan—had new platforms and engines. They were built by inexperienced factory hands in a new facility in Canton, Miss. Even some of the parts and tools were new to Nissan.

All of the new trucks and vans built in Canton turned out to have flaws. Customers griped of squeaks and rattles on the rooftops of some Armadas weren't welded on securely, and the side doors on Quest minivans opened at high





## The UAW wouldn't stand for Nissan-style job cuts

eroded Renault's former high margins, now a mediocre 2.7%. Although Renault and Nissan together have saved about \$600 million by sharing engines and have jointly developed small and midsize cars, Renault's operating

profits will barely top \$1 billion this year, about one-third of last year's number, according to Morgan Stanley. More than half of that comes from Renault's 44% Nissan stake. But even now, he points out, Renault is making money. "We're at the low point of our product cycle," Ghosn says. "If you're profitable at the low point you'll be in good shape" as sales pick up.

### PROMISE MAKER

GM OR FORD would present challenges different from those Ghosn has tackled in the past. Consider labor unions. When he slashed 21,000 jobs globally and closed five plants in Japan, he faced a public outcry. But it will be tougher to slash the \$1,000 or more per-vehicle that American carmakers pay in retiree benefits. He couldn't cut into those the way he forced layoffs in Japan. And after multiple failed attempts at unionizing Nissan plants in the U.S., animosity between the United Auto Workers and Ghosn runs deep.

The hard-charging CEO vows to boost sales and profits at both companies. If there's one thing that makes him stand out among auto industry brass, it's that he delivers on promises. He made good on all his targets at Nissan and pledged to quit if he failed. Now, Ghosn swears that Nissan's profits will start rising this fall when the new models arrive. At Renault, where his drive to boost performance kicked off earlier this year, he has more new models being prepared for showrooms next year, which might bring him closer to his goal of increasing margins to 6%. Meanwhile, the Logan, a \$6,500 subcompact, is beating all sales targets. Though the car was developed before Ghosn took over at Renault, it will help him meet a target of boosting global sales by 800,000 vehicles by 2009. Few would bet against Ghosn—with good reason. But if a Detroit alliance develops, his legend is sure to face new scrutiny.

—With Gail Edmondson in Frankfurt and Ian Rowley in Tokyo

### NO MERE ORNAMENT

He has delivered on promises to boost sales and profits

eds. JPMorgan Securities's warranty costs per vehicle have nearly tripled in the past 10 years, to almost \$500, and they go even higher. While Nissan still has the industry's best profit margins, the cost of improving quality could use it to lose that crown to Toyota Motor Corp. and Honda Motor Co. Despite recent wins, J.D. Power & Associates Inc. ranks Nissan's quality below average. "In 2004 and 2005 we made significant progress on quality," Ghosn says. "We'd like to move faster, but sometimes you have to change specs or change designs to do it." The CEO must also wrestle with the tough situation he inherited when he took the helm at Renault in April, 2005. The

French company's share of the European market has fallen to 9.1%, from 10.3% a year ago. Luxury brands such as BMW, Audi, and Mercedes have stolen buyers from Renault with small luxury cars costing under \$30,000. Renault's attempts to counter with gussied-up sedans such as the Vel Satis and Laguna haven't worked. To get back on track, Ghosn is preparing a raft of new models to hit showrooms starting next year and is aggressively targeting new markets, particularly in Asia. A key part of his plan: change Renault's product mix so that its lineup features more higher-margin vehicles.

Steep competition, a slowdown in new launches, and rising materials costs have

**BusinessWeek** online For a Q&A with Ghosn, please go to [businessweek.com/extras](http://businessweek.com/extras)



## TRADE

## WHY THE GAP WON'T STOP GROWING

U.S. consumers can't get enough of Chinese goods. Take a look

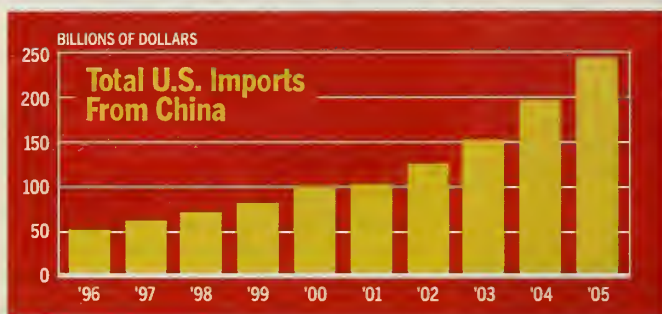
BY NICHOLA SAMINATHER

**C**an anything stop the Chinese export machine? In August the mainland's trade surplus hit \$18.8 billion—the fourth straight month with a record-setting gap. For the year to date, the surplus stands at \$94.7 billion, 57% ahead of a year ago.

Although China's imports jumped to a record \$72 billion, exports surged nearly a third to—yes, another record—\$90.8 billion. And much of that gap can be attributed to the vast quantities of goods

shipped to eager American consumers. For the year, China's exports to the U.S. look set to approach \$300 billion, up from \$243 billion in 2006.

Just what are Americans buying? Numbers won't be available until 2007, but it's a safe bet that gizmos such as TVs and iPods were popular. U.S. Commerce Dept. data show that electronic gear was the largest category of imports from China last year. That's a big change from a decade ago, when low-tech manufactured goods dominated. Below, the true scope of America's imports from China. ■



Data: Commerce Dept.



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# What's Really Propping Up The Economy

Since 2001, the **health-care** industry has added **1.7 million jobs**.  
The rest of the private sector? **None.**

By Michael Mandel

**IF YOU REALLY WANT TO UNDERSTAND WHAT MAKES THE U.S.** economy tick these days, don't go to Silicon Valley, Wall Street, or Washington. Just take a short trip to your local hospital. Park where you don't block the ambulances, and watch the unending flow of doctors, nurses, technicians, and support personnel. You'll have a front-row seat at the health-care economy.

For years, everyone from politicians on both sides of the aisle to corporate execs to your Aunt Tilly have justifiably bemoaned American health care—the out-of-control costs, the vast inefficiencies, the lack of access, and the often inexplicable blunders.

But the very real problems with the health-care system mask a simple fact: Without it the nation's labor market would be in a deep coma. Since 2001, 1.7 million new jobs have been added in the health-care sector, which includes related industries such as pharmaceuticals and health insurance (page 62). Meanwhile, the number of private-sector jobs outside of health care is no higher than it was five years ago.

Sure, housing has been a bonanza for homebuilders, real estate agents, and mortgage brokers. Together they have added more than 900,000 jobs since 2001. But the pressures of globalization and new technology have wreaked havoc on the rest of the labor



market: Factories are still closing, retailers are shrinking, and the finance and insurance sector, outside of real estate lending and health insurers, has generated few additional jobs (page 60).

Perhaps most surprising, information technology, the great electronic promise of the 1990s, has turned into one of the biggest job-growth disappointments of all time. Despite the splashy success of companies such as Google and Yahoo!, businesses at the core of the information economy—software, semiconductors, telecom, and the whole gamut of Web companies—have lost more than 1.1 million jobs in the past five years. Those businesses employ fewer Americans today than they did in 1998, when the Internet frenzy kicked into high gear.

## Attitude Shift

MEANWHILE, HOSPITAL administrators like Steven Altschuler, president of Children's Hospital of Philadelphia, are on a hiring spree. Altschuler has added the equivalent of 4,000 new full-time jobs since he took over six years ago, almost doubling the hospital's workforce. To put this in perspective, all the nonhealth-care businesses in the Philadelphia area combined added virtually no jobs over the same stretch.

Altschuler plans to add 3,000 more employees over the next five years as the hospital, one of the nation's leading pediatric centers, spends \$1.7 billion to expand. Next up is a new 1.2 million-square-foot research facility that will be packed with well-



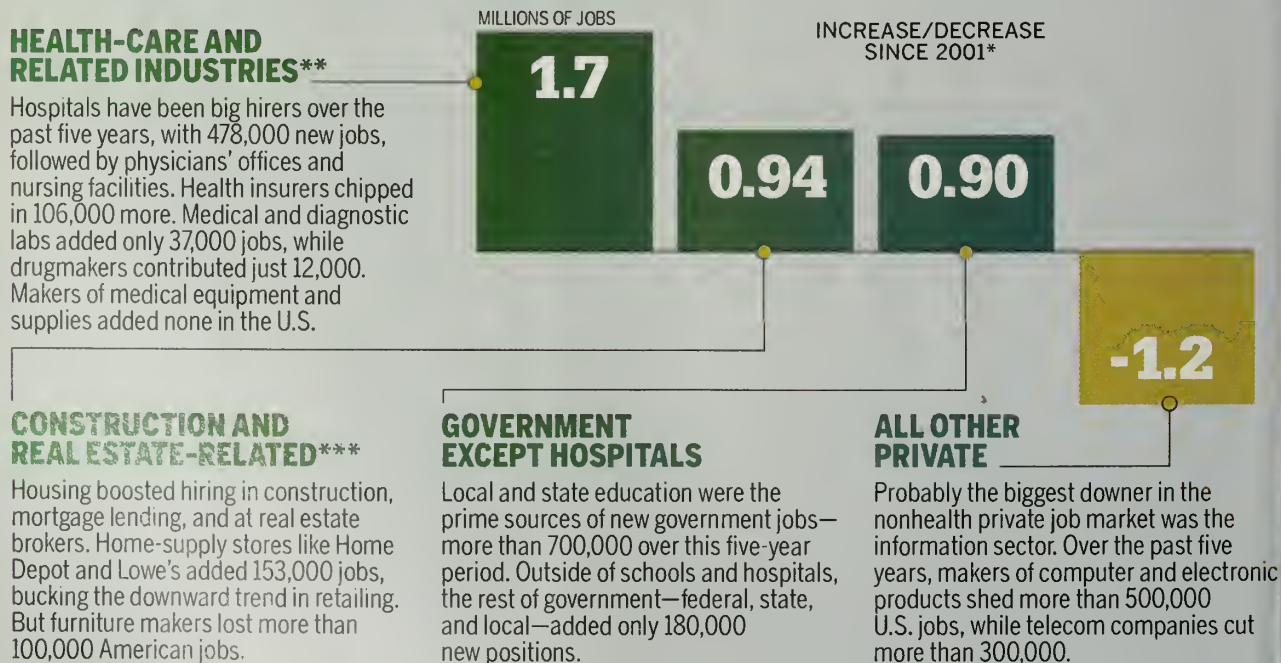
**"MUCH BETTER"**  
Nursing student  
McDonald used to  
sell insurance

paid scientists and support staff. "Health care is the major engine for the economy of the city of Philadelphia," says Altschuler.

The City of Brotherly Love is hardly alone. Across the country, state and local politicians, desperate for growth, are crafting their economic development strategies around biotech and health care. California will pour \$3 billion into stem cell research over the next 10 years, and other areas are on the same

## THE TRUE PICTURE OF THE JOB RECOVERY

Over the past five years, jobs created by the housing boom were more than swallowed up by losses from the info tech bust. That left health care as the main source of private-sector job growth.



\*Year ending in July, 2006, compared with year ending in July, 2001

\*\*Industries including health care services, pharmaceuticals, government hospitals, drugstores, medical equipment and supplies, and health-insurance providers

\*\*\*Industries including construction, building supplies, real estate brokers, mortgage brokers, furniture and appliance manufacturing and distribution, home-supply stores, architects, and interior designers

ath. "Our downtown business leaders and politicians have traditionally considered health care as a cost center, not as an economic engine," says Baiju R. Shah, a former McKinsey & Co. consultant who runs Cleveland's BioEnterprise, a nonprofit founded four years ago to stimulate the local health-care and bioscience industries. "But people are waking up."

What they're waking up to is the true underpinnings of the much vaunted American job machine. The U.S. unemployment rate is 4.7%, compared with 8.2% and 8.9%, respectively, in Germany and France. But the health-care systems of those two countries added very few jobs from 1997 to 2004, according to new data from the Organization for Economic Cooperation & Development, while U.S. hospitals and physician offices never stopped growing. Take away health-care hiring in the U.S., and quicker than you can say cardiac bypass, the U.S. unemployment rate could be 1 to 2 percentage points higher.

Almost invisibly, health care has become the main American job program for the 21st century, replacing, at least for the moment, all the other industries that are vanishing from the landscape. With more than \$2 trillion in spending—half public, half private—health care is propping up local job markets in the Northeast, Midwest, and South, the regions hit hardest by globalization and the collapse of manufacturing (map).

Health care is highly labor intensive, so most of that \$2 trillion ends up in the pockets of workers. And at least so far,

there's little leakage abroad in terms of patient care. "Health care is all home-produced," says Princeton University economist and health-care expert Uwe Reinhardt. The good news is that if the housing market falls into a deep swoon, health care could provide enough new jobs to prevent a wider recession. In August, health-services employment rose by 35,000, double the increase in construction and far outstripping any other sector.

John Maynard Keynes would nod approvingly if he were alive. Seventy years ago, the elegant British economist proposed

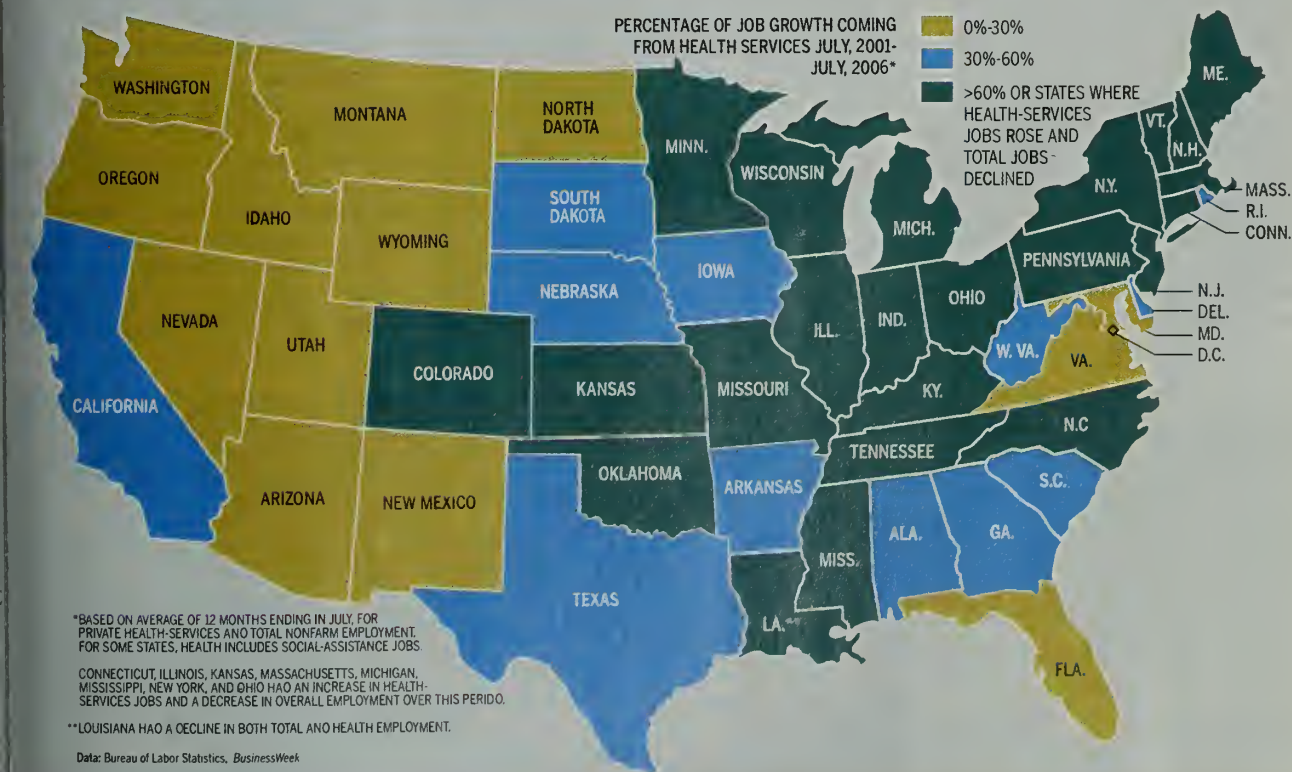
## For now, health hiring is providing a safety net in areas where retail and manufacturing are in decline

that in tough times the government could and should spend large sums of money to create jobs and stimulate growth. His theories are out of fashion, but substitute "health care" for "government," and that's exactly what is happening today.

Make no mistake, though: The U.S. could eventually pay a big economic price for all these jobs. Ballooning government spending on health care is a major reason why Washington is running an enormous budget deficit, since federal outlays for health care totaled more than \$600 billion in 2005, or roughly one quarter of the whole federal budget. Rising prices for medical care are making it harder for the average American to afford

## THE HEALTH BELT

Like a wide sash, the main areas depending on health-care hiring go from **Maine to Pennsylvania, across the Midwest, and then down South.**





health insurance, leaving 47 million uninsured.

Moreover, as the high cost of health care lowers the competitiveness of U.S. corporations, it may accelerate the outflow of jobs in a self-reinforcing cycle. In fact, one explanation for the huge U.S. trade deficit is that the country is borrowing from overseas to fund creation of health-care jobs.

There's another enormous long-term problem: If current trends continue, 30% to 40% of all new jobs created over the next 25 years will be in health care. That sort of lopsided job creation is not the blueprint for a well-functioning economy. One solution would be to make health care less labor-intensive by investing a lot more in information technology. "Low productivity in health is mostly a product of low investment," says Harvard University economist Dale Jorgenson.

For now, though, health-care hiring is providing a safety net in areas where manufacturing and retailing are no longer dependable sources of jobs. Take Johnstown, Pa., a town that once hummed with activity from local steel mills, coal mines, and nearby factories. As most of these businesses closed, the town emptied out, going from a population of 63,000 in 1950 to 23,000 today.

Now, Conemaugh Health System, with about 5,000 workers, is the biggest employer in town. "Everyone has a Conemaugh parking sticker on their car," says Linda D. Suter, 48, who's in her second year at the nursing school Conemaugh operates.

## The bad news: Health care needs so many workers in part because there's been too little investment in info tech

Suter's dad worked at a factory in a nearby town, now closed, that made backyard swing sets for kids.

Frank Kosnowsky sold appliances at the Sears in Johnstown for 10 years, starting right out of high school. But he got fed up with the way the company was changing and started thinking about going to nursing school. "One day I had a disagreement with my boss, and the application went right in," says Kosnowsky, 29. "I wanted something that had a future." He worked part-time at Sears while he went to nursing school.



**DISEASE DETECTIVE**  
Hakonarson is looking at the genetic components of childhood illnesses

Now, three years later, he's the first and only male nurse working at Conemaugh's neonatal intensive-care unit—career far different than that of his coal miner dad.

Suter and Kosnowsky live smack in the middle of the "Health Belt" that stretches from New England down through New York and Pennsylvania, across the Midwest and down through most of the South. These are areas where health care has been the major source of job growth over the past five years.

Nowhere is that truer than in Cleveland. There, Cleveland Clinic, with 29,000 employees, is the biggest employer by far. Next-largest is another hospital system, University Hospitals Health System, with 21,600 staffers. Then comes insurer Progressive Corp. and KeyCorp., each with fewer than 10,000 workers in the area. Cleveland Clinic's performance is pretty good for an organization

that started in 1921 with four docs in a building they planned to turn into a hotel if their vision didn't pay off.

Beyond its immediate employment tallies, the Clinic has a huge multiplier effect on the local economy. CEO Dr. Delos Cosgrove says it supports perhaps 75,000 jobs in all in the area ranging from Clinic staffers to workers at hotels and restaurants—which patients and their families use in more than 1 million patient visits per year—to 3,000 suppliers to the Clinic.

Only a few years ago manufacturers were Cleveland's job





nes. Companies such as machine-tool giant Warner & Swasey Co. don't even exist anymore. Conglomerate TRW was sold in 2002, and parts of it moved away. Fittingly, the Clinic now occupies its former headquarters, which TRW donated.

Health care has been one of the few economic bright spots in the Detroit area, too. Nancy M. Schlichting heads the sprawling Henry Ford Health System, founded by the great man himself in 1915. Schlichting is overseeing the construction of a new 300-bed hospital in West Bloomfield, Mich., a suburb of Detroit, which will eventually generate the equivalent of 1,200 full-time jobs. This expansion comes at a time when Ford Motor Co. is considering big layoffs.

Then there's North Carolina. Since 2001 it has seen a total job increase of 24,000, or 0.6%. Meager enough—but take out the 60,000 jobs added by health care, and the state's jobs would have decreased by 36,000. Employment in manufacturing, retailing, trucking, utilities, and information all fell. And construction added only 10,000 jobs, a mere fraction of health care's contribution.

Oddly enough, the retirement meccas of Florida and Arizona are among the most dependent on health-care jobs for growth. Over the past five years the two states have gotten only 10% and 15%, respectively, of their new jobs from health-care services—hospitals, doctor's offices, and nursing homes. Phoenix showed a job gain of 240,000, but only 30,000 were in health care. That's partly because the influx of elderly has been balanced by a loss in younger workers, too.

Is the health-care economy a good deal for workers? It is for Patricia A. McDonald, a second-year student nurse at Cone-Nease. Before going to nursing school, McDonald, 46, sold insurance door-to-door, often driving close to 1,000 miles a week in rural areas to make cold calls. Her take in sales commissions was \$35,000 to \$40,000 a year, but that was before deducting expenses. Registered nurses in the Johnstown area, by comparison, are paid an average of almost \$33,000—with no traveling. "This will be much better," says McDonald.

Unlike many other industries, health

care offers a full range of jobs, from home health aides making very low wages through technicians and nurses making middle-class salaries up to well-paid doctors. On average, annual pay in private health services is \$43,700, slightly above the private-sector average of \$42,600.

## Ripple Effect

EVEN MORE PROMISING, health care has taken over the role manufacturing used to play in providing opportunities for less skilled workers to move up. Jeffrey Lites started as a part-time cashier in the cafeteria at Philadelphia's Children's Hospital in 1996 after being laid off as a computer operator. "I never envisioned working in a hospital," says Lites. But now, close to finishing his degree in early childhood education from Temple University, Lites works as a child-life assistant, providing recreation and activities for young patients who may stay for weeks or even months. "I have the best job in the entire hospital," says Lites, who moonlights as a musician on weekends.

The expansion of health care is also spinning off related jobs. Cleveland Clinic Innovations, a unit that funds startups, has already created 19 companies in its five years of existence. Together they employ about 186 people, including more than 50 in the Cleveland area. One, Cleveland BioLabs Inc., went public in July and trades on NASDAQ. "We like to say that the New Economy is alive and well in the 40 blocks of the Cleveland Clinic," says Christopher Coburn, executive director of Cleveland Clinic Innovations.

James A. Martin is pursuing the same pot of gold in Shawnee, Kan., a city of almost 60,000 located just outside Kansas City. Martin, executive director of the Shawnee Economic Development Council, is helping the city set up a biosciences development district, the first in the state. He's hoping to build on the jobs already there, including the animal-health division of Bayer HealthCare. "The high growth potential of biosciences jumped out at us," says Martin. "We got the bug."

## IT BEATS BUILDING HOUSES

Average annual wages and salaries in 2004\*

(Thousands of dollars)

|                                 |       |
|---------------------------------|-------|
| <b>SECURITIES</b>               | 164.8 |
| <b>INFORMATION</b>              | 65.7  |
| <b>BANKING</b>                  | 56.3  |
| <b>WHOLESALE TRADE</b>          | 55.3  |
| <b>DURABLE MANUFACTURING</b>    | 51.1  |
| <b>NONDURABLE MANUFACTURING</b> | 44.8  |
| <b>HEALTH SERVICES**</b>        | 43.7  |
| <b>ALL PRIVATE INDUSTRIES</b>   | 42.6  |
| <b>CONSTRUCTION</b>             | 41.9  |
| <b>TRUCKING</b>                 | 39.7  |
| <b>RETAIL</b>                   | 28.2  |
| <b>AMUSEMENT AND GAMBLING</b>   | 24.5  |
| <b>HOTELS AND RESTAURANTS</b>   | 19.9  |

\*Full-time-equivalent workers

\*\* Hospitals, doctors' offices, and nursing homes

Data: Bureau of Economic Analysis

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Scott Becker, CEO of Conemaugh, is leading the effort to develop a technology park in a prime location in the center of Johnstown, where a mammoth dairy used to be. Potential biotech and info tech tenants include a company dealing with electronic medical records and another that's involved with drug trials. "The goal is to bring a new, younger workforce back to town," says Becker.

## Unbalanced

SHAH OF CLEVELAND'S BioEnterprise cautions that biotech may not be the right economic development strategy for many places. For one, it's hard to develop a local biotech industry from scratch. "I've seen a lot of regions that take a swing at that," says Shah. Besides, he says, biotech mainly provides jobs for a small number of highly paid workers. For many communities, Shah favors a broader strategy of encouraging health-care delivery and medical equipment and supplies.

Still, using health-care spending to create the vast majority of new jobs, while beneficial in the short run, is not desirable over the long run. A well-balanced economy needs to provide a wide variety of jobs, not just positions for doctors, nurses, and medical technicians.

The biggest worry is that demand for health care will absorb too much of the workforce and squeeze out other types of jobs. If medical spending rises to 25% of gross domestic product by 2030, as many economists expect, health care's share of jobs could grow to 15% or 16% of the labor market from today's 12%, based on historical patterns.

Such a shift in employment would require health care to be the single biggest creator of jobs in the economy for the foreseeable future. And while the U.S. could in theory afford to spend 25% of GDP on health care, it's hard to imagine a world in which our children have to choose between working for the local hospital or the local health insurer.

The real question, then, is whether it is possible to restructure the health-care system to provide equally good care with fewer workers. The answer is yes, say some experts. "What we have consistently found is that the supply of physicians, except at the low end, has rather little influence on patient outcomes," says David Goodman, a professor at Dartmouth Medical School



**RETAIL REFUGEE**  
Nurse Kosnowsky used to sell appliances at Sears

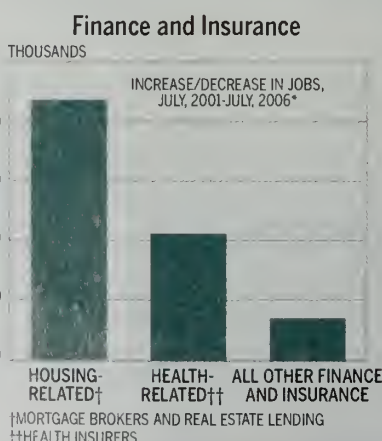
who started his career as a pediatrician in a rural county in Northern New Hampshire. Jonathan Weiner, a professor at Johns Hopkins University Bloomberg School of Public Health

agrees: "I am absolutely certain that we can provide quality health care with fewer doctors."

These assertions miss the point, says Richard Cooper, professor at the University of Pennsylvania School of Medicine. Cooper, a former dean at the Medical College of Wisconsin, argues that the health-care workforce grows along with real incomes and GDP. "When you get richer, you aren't going to triple your food expenditures," says Cooper. "But there's much more that can be done to improve health." Princeton economist Reinhardt concurs, noting that "if you did geriatric

## WHERE THE JOBS AREN'T

Take out the health-care and housing booms, and what's left? Not much, it turns out:



**Information**

INCREASE/DECREASE IN JOBS, JULY, 2001-JULY, 2006\* (THOUSANDS)

|                                                               |        |
|---------------------------------------------------------------|--------|
| INFO TECH EQUIPMENT                                           | -511   |
| MANUFACTURING AND REPAIR                                      | -332   |
| TELECOM AND BROADCASTING                                      | -183   |
| SEARCH PORTALS, INTERNET PUBLISHING, AND OTHER WEB BUSINESSES | -115   |
| SOFTWARE PUBLISHING AND COMPUTER SYSTEMS DESIGN               | -7     |
| WHOLESALE AND RETAIL DISTRIBUTION OF INFO TECH EQUIPMENT      | 5      |
| ONLINE SHOPPING                                               | -1,143 |
| <b>INFORMATION SECTOR TOTAL</b>                               |        |

Data: Bureau of Labor Statistics



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health properly, you'd need a lot more geriatricians."

But both sides can agree that more spending on information technology could reduce the need for so many health-care workers. It's a truism in economics that investment boosts productivity, and the U.S. lags behind other countries in this area. One reason: "Every other country has the payers paying for IT," says Johns Hopkins' Gerard Anderson, an expert on the economics of health care. "In the U.S. we're asking the providers to pay for IT"—and they're not the ones who benefit.

Breakthroughs in technology offer other enticing possibilities for making health care less labor-intensive over the long run. Hakon Hakonarson just moved from Iceland to start up the new Center for Applied Genomics at Children's Hospital of Philadelphia. Hakonarson's group is using cutting-edge automated technology to analyze hundreds of DNA samples from hospital patients and their parents per day, something that wasn't possible until recently. His aim is to collect enough data within a short period of time to understand the genetic causes of childhood diseases and determine which children will respond best to which drugs. "If we go at this pace," says Hakonarson, "we will have something very powerful to analyze before yearend." The eventual result could be better,

## Deeper into the Health-Care Bonanza



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cheaper treatments, with fewer expensive side effect

Meanwhile, Hakonarson employs 10 people in his lab as we as five nurses and medical assistants in the field who do nothing but ask families to participate in the study. For now, the health-care economy marches on. ■

—With Joseph Weber in Chicago

## How We Looked Inside

**F**or this article, *BusinessWeek* built up a picture of the broad health-care industry using job data from the Bureau of Labor Statistics. At the heart of the health-care sector, of course, is private health services, ranging from mega-health systems such as the Cleveland Clinic down to small private physicians' practices. But the health-care sector also includes companies that are developing and manufacturing drugs,

medical supplies, and equipment; health-insurance providers; wholesalers and retailers of drugs, medical equipment, and supplies; health charities; and government-run hospitals. So a biotechnology company such as Amgen Inc. would be in the health-care sector, as would the American Heart Assn. and the hospital system run by the Veterans Affairs Dept.

Using this definition, the health-care sector represents 12% of the total workforce

today (table). Hospitals alone, private and public, employ 5.7 million workers—over 4% of the total workforce.

Our analysis used 12-month averages to smooth out statistical blips, a big issue at the state level. The end date, July, 2006, is the latest month for which job figures for all industries are available. The baseline date, July, 2001, is exactly five years earlier, thereby avoiding problems with seasonal variation.

That date also has the virtue of being very close to the month—June, 2001—when 12-month average employment hit its high for the boom. That means employment in today's reasonably good labor market is being compared with employment at the previous peak, which is the right way to do the calculations.

## A NEW VIEW OF HEALTH CARE



|                                            | THOUSANDS OF JOBS<br>JULY, 2006* | RISE IN NUMBER OF JOBS,<br>IN THOUSANDS<br>JULY, 2001-JULY, 2006* |
|--------------------------------------------|----------------------------------|-------------------------------------------------------------------|
| PRIVATE HEALTH-CARE SERVICES               | 12,479                           | 1,447                                                             |
| GOVERNMENT HOSPITALS                       | 1,277                            | 86                                                                |
| DRUGSTORES AND OPTICAL-GOODS STORES        | 803                              | 7                                                                 |
| HEALTH-INSURANCE CARRIERS                  | 439                              | 106                                                               |
| WHOLESALE MEDICAL EQUIPMENT AND DRUGS      | 394                              | 45                                                                |
| MEDICAL SUPPLIES AND EQUIPMENT             | 379                              | 0                                                                 |
| PHARMACEUTICAL COMPANIES                   | 290                              | 12                                                                |
| HEALTH CHARITIES AND RELATED ORGANIZATIONS | 39                               | 3                                                                 |
| TOTAL                                      | 16,100                           | 1,707                                                             |
| SHARE OF TOTAL NONFARM EMPLOYMENT          | 12%                              |                                                                   |

\*Average for 12 months ending in July, 2006

Data: Bureau of Labor Statistics



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# EVERYTHING OLD IS NEW AGAIN



# Companies such as Caterpillar are turning junk into gold by giving their reclaimed parts a new lease on life

BY BRIAN HINDO

**N**OTHING IS AS SYMBOLIC of American industrial might than the sprawling Ford Motor Co. plant on the River Rouge in Dearborn, Mich. It was a city unto itself, covering 15 million square feet, with its own power plant, hospital, and smokestacks reaching to the sky. A boat slip once welcomed freighters from all corners of the world bearing wood, metal, soybeans, and other raw materials destined for Ford's steel mills, glassworks, and plastics foundry. But Henry Ford's genius wasn't just scale: It was organizing labor in a hyper-productive way—one that took advantage of the world's seemingly endless supply of cheap natural resources.

That plant was the apotheosis of modern manufacturing. But we all know what has happened to Ford, and U.S. industrial companies generally, since the glory days of the early and mid-20th century. Labor has become virtually a global commodity. All the Model T-era organizational innovation, and all the subsequent productivity drives, still run smack into the reality that workers come at a tenth of the price in other countries. What's the use?

In fact, there's another way to compete. Consider a much more humble operation, a Caterpillar Inc. plant in Corinth, Miss., a small town in the state's northeast corner. The operation consists of a clutch of long, narrow low-rise buildings in an industrial park. Inside, it all looks like a fairly typical engine factory, except things actually move a bit slowly, and everything is happening in reverse. Indeed, the whole point of the plant is not to put things together but to pull them apart.

Every day, about 17 truckloads worth of used diesel engines—some almost as big as Hyundais—and other parts are dumped at a receiving facility. The filthy-caked iron carcasses are then broken down by hand. One engine usually takes two workers, surrounded by buckets, hammering and drilling for half a day, until they've plucked the engine clean of every last bolt and chucked each component into its own bin. It all must be salvaged, because even the puniest screw will be reused to assemble a "like new" engine. "If they throw anything away," says facility manager Tony Miller, an accountant by trade, "they just throw money in the trash."

This is the beginning of a process called remanufacturing. The simple twist is that this process places as much focus on wringing productivity out of physical materials as out of labor. As a general rule, 70% of the cost to build something new is in the materials and 30% of it in the labor. Remanufacturing asks: Why not work on the larger component?

People have been rebuilding things as long as there have been tools, but a small cadre of forward-thinking companies have spotted opportunity anew in the process. Big companies that do it include General Electric and Xerox, and smaller outfits such as carpet maker Interface and oil and gas services company Hanover Compressor do it, too. Lately none has been embracing reman-

ufacturing as aggressively as Caterpillar. All these companies are reclaiming products after they've been used one or more life cycles. They then start the manufacturing process over again with materials that are essentially free—with all the energy costs already baked right in. The

## THE STAT

Salvaging materials flip-flops the traditional cost structure

### NEW

Materials cost:

**70%**

### REMANUFACTURING

Materials cost:

**40%**

and the total cost is much smaller

Data: Boston University



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business model becomes only more compelling as metals and minerals hover near record prices, and as oil—the lifeblood of industry—flirts with \$70 a barrel.

Remanufactured products can cost, on average, half of what new ones do, and the business can be terrifically profitable for companies that do it well. At Caterpillar, the “re-man” operation’s margins so impressed company brass that they made the business a separate division last year. The unit racked up more than \$1 billion in sales in 2005 and is expected to grow 15% annually for the next several years at least. That’s a sliver of the \$36 billion heavy equipment giant’s overall revenue picture. But remanufacturing is one of Caterpillar’s fastest-growing divisions.

## The Cost Advantage

FOR ALL the dirty work involved—mining trash for old, essentially—there’s an elegant appeal to remanufacturing. The would-be disards become fodder for the next product life cycle, eliminating waste and closing the loop on the system. That appeals to make it quite an environmentally friendly business process, championed by greenies as a “sustainable” business model. And at a time when many expect high natural resource costs to persist, companies such as Caterpillar firmly believe that remanufacturing gives them a long-term advantage over companies that continue to start from scratch each time.

It’s appropriate that Miller, the facility

manager, and his boss, division Vice-President Steven L. Fisher, have backgrounds in finance, not operations: Remanufacturing befits a thrifty disposition. The basic question managers must consider is: How much does a new widget cost vs. a remanufactured one?

## PLAYBOOK: BEST-PRACTICE IDEAS

### The Virtuous Cycle

A successful remanufacturing operation has to be good at wringing productivity out of materials and resources, as well as out of labor. Here’s how it differs from traditional manufacturing:

**DESIGN** Even before they are built new, remanufactured products have to be designed for disassembly. That may mean adding cost up front—another layer of metal, or a bolt fastener vs. a snap. But the payoff will come when the company saves labor and materials costs during a product’s second, third, and fourth life cycles.

**LOGISTICS** A company needs to know where its products are in order to take them back. Otherwise, it will spend too much money trying to figure out how to collect them. This is known as the art of “reverse logistics.” One way to do it is by having robust dealer relationships; another is by giving financial incentives to big clients for participating in remanufacturing.

**LOW FASHION** You can’t remanufacture fashion. “Reman” is mostly used in heavy industrial applications, where customers care more about performance than looks, rather than the consumer sector, where novelty is a key marketing point. Still, even some high-tech consumer companies such as cell-phone makers use remanufactured goods as warranty replacements.

Data: BusinessWeek, Rochester Institute of Technology, Boston University, company reports

To see how the economics work, consider one of the more prosaic examples from Caterpillar’s reman operation: the fuel injector case, a little groove-headed piece of metal that helps spray fuel into a diesel engine’s combustion chamber. The cases would usually come back into the reman facility pretty beaten up, the grooves worn down after half a million

miles of use. “For years we just threw them in the scrap bin,” says Fisher. “The part costs about \$3.” But engineers found a way to reconstitute the groove to like-new condition. Fisher explains: “We actually take a laser [and use it to] put metal inside that groove, and then remachine it. It costs us 50¢. And we’re doing about a million of these a year.”

For all of the old-school manual labor involved in remanufacturing, there is a startling amount of research involved. An ad hoc research and development unit occupies a broad swath in the middle of the Corinth plant, where metallurgical engineers puzzle over how to resuscitate all sorts of engine parts. Processes they’ve developed are in use all around them: Behind one door, a machine pelts a cylinder head with a high-velocity aluminum spray to smooth minute imperfections. Around another corner, a welder pours molten iron onto a cracked engine block.

## Second Lives

EVEN WITH ALL those man-hours, remanufacturing pays off. Robert T. Lund and William Hauser, two engineering professors at Boston University, recently surveyed more than 270 remanufacturers. They found that, on average, labor and overhead represented about 60% of the costs to produce remanufactured goods. That’s nearly a complete inversion of the traditional cost breakdown between labor and materials. In most cases, according to managers that do it, the overall cost usually runs less than



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# The Corporation | Remanufacturing



70% of building a brand new product.

At its core, remanufacturing is as much a service business as a product business. For the process to work, companies can't just forget about their products once they are shipped from the factory. Instead, they have to form a replacement relationship with customers.

Part of the reason reman is so successful at Caterpillar is that the Peoria company knows exactly where all of its equipment is. It sells exclusively through its own network of 200 dealers worldwide, who keep close tabs on their customers and their goods. So when a customer is ready to replace an engine or part—what Cat calls “cores”—Caterpillar can track the used piece and know when it will get to Mississippi. “[If you] get 10,000 cores back one day, and then nothing for three weeks, it's hard to run an operation,” says Fisher.

**CORINTH, MISS.** An engine comes in dirty; above, metal imperfections are coated

To manage the logistical challenge, Cat relies on a simple principle, one that Fisher likens to the old Coke bottle deposits you would make at the grocery store. When a customer replaces a crankshaft, say, he's offered a remanufactured one for about half the price. But he'll be charged in full unless he turns in an old crankshaft that can be fed back into the remanufacturing loop in Corinth. In fact, until a turned-in part is inspected and certified as remanufacturable, the customer won't get the half-price credit. Corinth is kept well-fed enough to pump out about 75 remanufactured engines or engine blocks a week.

In essence, customers are given an incentive to become Caterpillar's partner. They're actually creating assets, in the form of the returned cores, for their supplier. In return, they're quickly getting a low-cost replacement, so they can keep their fleets running with little downtime. “If you're doing this in small volumes, it is hard to justify the investment in sys-



tems and technology and everything to make sense out of it,” says Fisher. “But Cat's man [is] getting 2 million units back each year, so you can make this kind of investment and it does make sense.”

## Designed to Last

FOR CATERPILLAR, one of the most important

steps in the remanufacturing process happens long before the used engine hits the sorting facility in Corinth—even before the thing is built new in the factory. That's because Cat's product designers must explicitly consider the ease with which it can be remanufactured. In fact, there's a “reman” box on Cat's product development checklist. “We actually have reman engineers working with new engineers, saying, ‘You know, if you put another 10-thousandth of [an inch of] metal on that, we can get two lives out of that,’” Fisher says. “It may cost a dollar more when we produce it new. But we get two or three or four more lives out of it, because of designing it to be remanufactured.”

It's another way that remanufacturing thinking upends conventional manu-

## More on Remanufacturing

**What's Next:** Rochester Institute of Technology engineers figure out how to remanufacture everything from coffee urns to jet planes

**Commodity Hedge:** How carpet maker Interface plans to end its reliance on oil

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# The Corporation Remanufacturing

turing wisdom. Most companies would consider spending more up front to extend a product's life a colossally stupid idea. But Caterpillar is turning it into a competitive advantage. As Paul Hawken, an author on sustainability issues, puts it: In reman, "you design for utility, which is how useful is this when it comes back, rather than how useful is it going out."

## Not for Fashion Victims

FOR CATERPILLAR, remanufacturing has a powerful logic. That's why it has designs to roll up companies, big and small, that rebuild everything from railcars to auto parts. In fact, Cat Reman almost doubled its size with the \$1 billion acquisition of Albertville (Ala.) railcar servicer Progress Rail Services Corp. in June. Cat's products are capital goods—tools in the service of heavy industry. There's little value in Cat's world for fashion. Customers don't care what an engine looks like as long as it can power their tractor-trailer. Moreover, the diesel engine, though indeed a complicated wonder, isn't a technology-intensive good. Cat can reliably expect engines, or railcars, to be reasonably similar 15 years from now.

That's why it's hard to imagine Apple Computer Inc., for instance, getting into the iPod remanufacture business—even though it is technologically and commercially possible. The iPod is a perfect marriage of fashion and technology. The look should continue to be sleeker with each iteration, and the console should probably be smaller. The first version, circa 2000, already looks like a clunky antique compared with smaller, more powerful video iPods. Apple can't reuse the plastic casing, since the size and finish keeps changing.

But even if Apple could remanufacture the iPod, why would it want to? Like most consumer companies, its business model is built on the idea that people can be persuaded to throw away perfectly functional goods and buy stuff they want but don't actually need. "[Industrial] design was specifically invented to convince people

that the washing machine, the car, or the refrigerator they had was out of fashion," says Walter R. Stahel, an economist at the Product-Life Institute, a research and consulting firm in Geneva, Switzerland. "Fashion is something you cannot remanufacture."

That's why it's not surprising that the largest remanufacturer in the U.S. is the Defense Dept. In the military, function resoundingly trumps form. Nabil Nasr, an engineering professor at the Rochester Institute of Technology, estimates that the

built, much of the arsenal will simply have to be rebuilt to last another 20 years. The process is a natural fit. "The armed forces are always forced to have a system that also works if suddenly there is a shortage of resources," says Stahel. "Consumer society doesn't even think about the shortage of resources."

But industry might. It's not that companies will soon confront a dearth of natural resources. But the impact of high commodity prices is already rippling through the production cycle. At Interface, which reclaims carpet "the prices of raw material have increased 100% since we started this effort," say Stuart Jones, a vice-president there. "So just sitting here doing nothing, the economic get better almost daily as oil goes up."

Environmental laws also may force companies' hands. The European Union has rules that put companies on

**LAGRANGE, GA.** Carpet is cut and stacked at an Interface manufacturing plant



## Rebuilt To Last

A critical element in remanufacturing is easy access to used goods. Here's a look at some remanufactured products:

### DIESEL ENGINES

One big player is **Caterpillar**, which originally got into this business reluctantly, as a favor to big client Ford Motor.

### COMPRESSORS

These hulking devices, built by companies such as **Hanover Compressor**, help remove natural gas out of deposits.

### DISPOSABLE CAMERAS

Aside from the film itself, most of the product that **Kodak** made famous is reusable.

### CARPET TILES

**Interface** reuses the vinyl backing, and is working on a process to reclaim the face fibers on the top of carpets.

### COPIERS

At **Xerox**, the innards from remanufactured copiers go right back onto the new-build assembly line.

### CELL PHONES

Many manufacturers, including **Motorola**, use rebuilt handsets as warranty replacements.

Data: BusinessWeek, Rochester Institute of Technology, company reports

Pentagon spends about \$15 billion every year to extend the life of its goods. In a time of war, equipment needs to get out to the field. And rather than order all new tanks, planes, armored vehicles, and the like, or wait for ordered products to be

the hook for the post-consumer waste their products cause. So far, only modest recycling initiatives have bubbled up in the U.S., but most suspect this will change. Steven Fisher at Caterpillar thinks remanufacturing, which has as its goal the complete elimination of waste from its system—gives Cat good head start. "The one thing we send to the land from Corinth is food scraps from our cafeteria," he quips.

Most companies, though, aren't used to thinking about the things they expel—waste products, resources—have value. But to sustainability expert Hawken the growth of remanufacturing symbolizes "a long-term shift away from labor productivity toward source productivity." Economics, not environmental concerns, is the driving force

"It's not like you're doing it because you're a nice guy or because you think the EU shouldn't have so much chronic employment. You do it because you look at the numbers." ■

—With Michael Arndt in Chicago

A full-page photograph of Jonathan Ive, Apple's chief design officer, looking down at a white cable he is holding in his right hand. He is wearing a dark t-shirt. The background is a plain, light-colored wall.

in

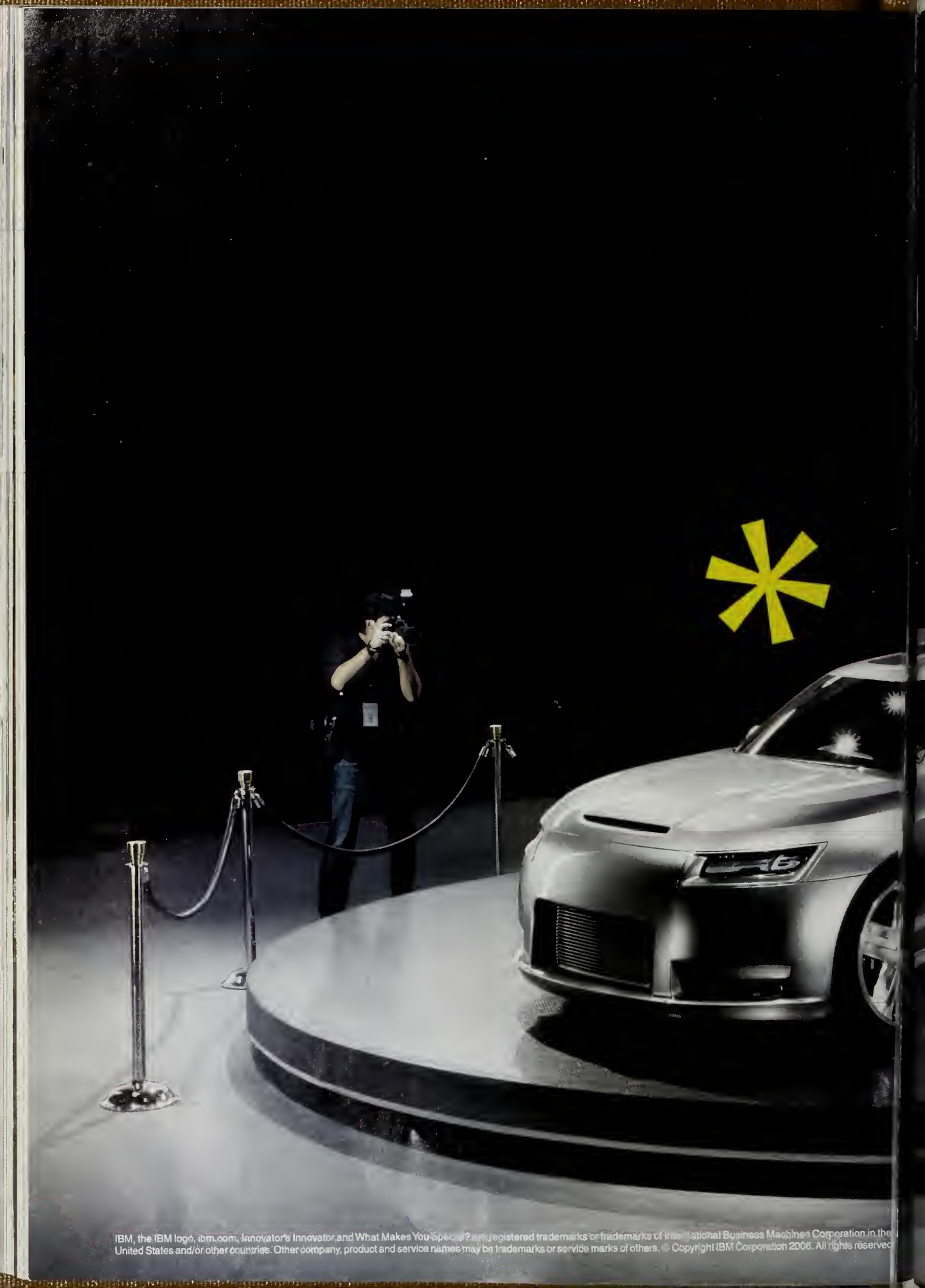
INSIDE INNOVATION

EMBER 2006

BusinessWeek

APPLE'S JONATHAN IVE





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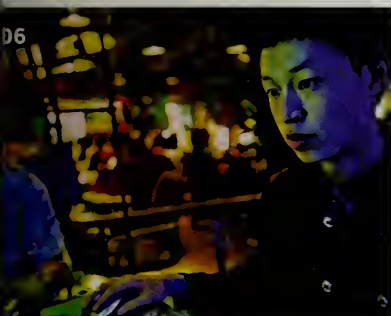
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Keep in touch by linking to our online Innovation & Design site ([businessweek.com/innovate](http://businessweek.com/innovate)) with its blogs, columnists, metrics, and stories.

BRUCE NUSSBAUM, EDITOR

**inshort**

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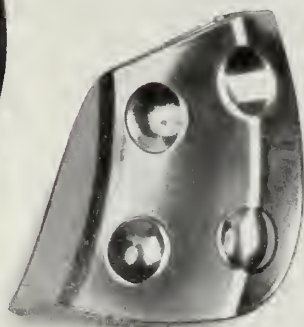


## TOOL: MATERIALS ARE HOT

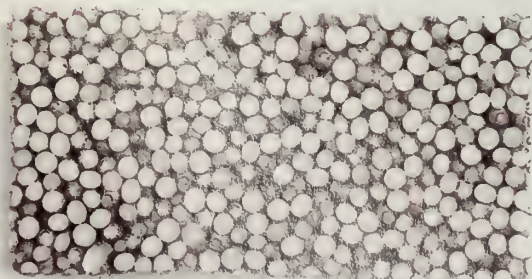
Great products make use of great materials and companies are always on the lookout for new ones. Here are a few good sources:

Inventables, a product innovation consultancy, sends out DesignAid packets of materials to a client list that includes Motorola, Samsung, and General Motors. They contain the latest new materials, preselected and offered up as a springboard for "Eureka!" moments. Material ConneXion is a global resource center with bases in New York, Milan, Bangkok, and Cologne. Corporate clients include Nike, Aveda, and Target, to name a few, seeking inspiration for new products based on state-of-the-art fabrics, glass, plastics, and other substances (many posted on Material ConneXion's online database). Princeton Architectural Press has a subscription-only service, *Materials Monthly*, that distributes boxes containing samples of cutting-

edge materials like biodegradable substances along with product histories and performance details.



Materials from Inventables: (top to bottom) flexible light, squishy metal, expandable foam

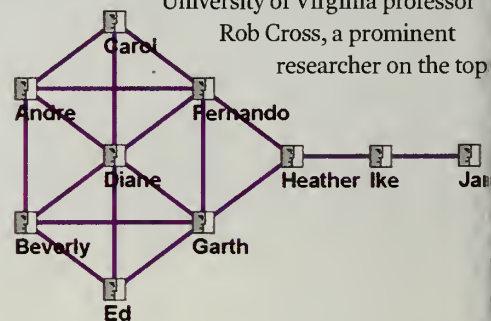


## TOOL: SOCIAL NETWORK MAPPING

Managers are mapping informal collaborative relationships to foster creativity. Accenture created a graphic web of social networks within clients' companies to analyze management. Siemens made a social network chart to show how its global software development team would work. Procter & Gamble joined a 53-member social network analysis consortium headed by

University of Virginia professor

Rob Cross, a prominent researcher on the top



## TOOL: TRIZ

Although it's gaining steam as a trendy method for fostering structured innovation, TRIZ (a Russian acronym for Theory of Inventive Problem Solving) is a 60-year-old strategy conceived by the late inventor and patent inspector Genrich Altshuller. Altshuller devised a matrix of 39 basic engineering problems and 40 possible solutions to solve them. Consultants say an updated, broader version can test inventiveness. Avon, BMW, Electrolux, GM, IBM, Johnson & Johnson, Motorola, Pfizer, Samsung, and Toyota are all using TRIZ. But managers beware: this pet tool of engineers is wildly complex and best suited for solving technical dilemmas.



## TREND: SIMULATIONS

Companies are turning to simulation technology to create digital models of systems, products, Web sites, and software before making physical prototypes, writing code, or marketing new products. Starwood is using the virtual world of Second Life to design a new hotel concept. Wachovia, Sprint and Deloitte Consulting are using iRise simulation software to test user interfaces of customer Web sites before programmers write code. Cold Stone Creamery uses a simulation video game to train sales staff. And frog design created a Flash simulation of an oven control system for TurboChef's new residential oven before making it.

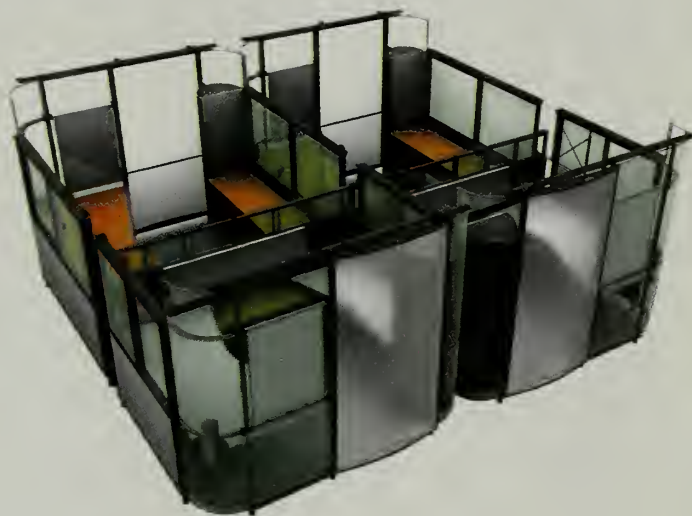
## TOOL: MAPPING COLLABORATIVE WORK

History Flow, a data visualization project developed at IBM's Watson Research Center, is a free-for-download tool that illustrates how collaborative authors work together and construct vast, fluid documents together on wikis. It has been used to track traffic and vandalism on Wikipedia, but its creators, Martin Wattenberg and Fernanda B. Viégas, are now studying how different wiki designs might affect what types of ideas and texts are produced. Because History Flow is still a research experiment, expect bugs—although users can e-mail their questions and comments and contribute to the further development of this work-in-progress.

## TREND: RETHINKING THE WORKPLACE

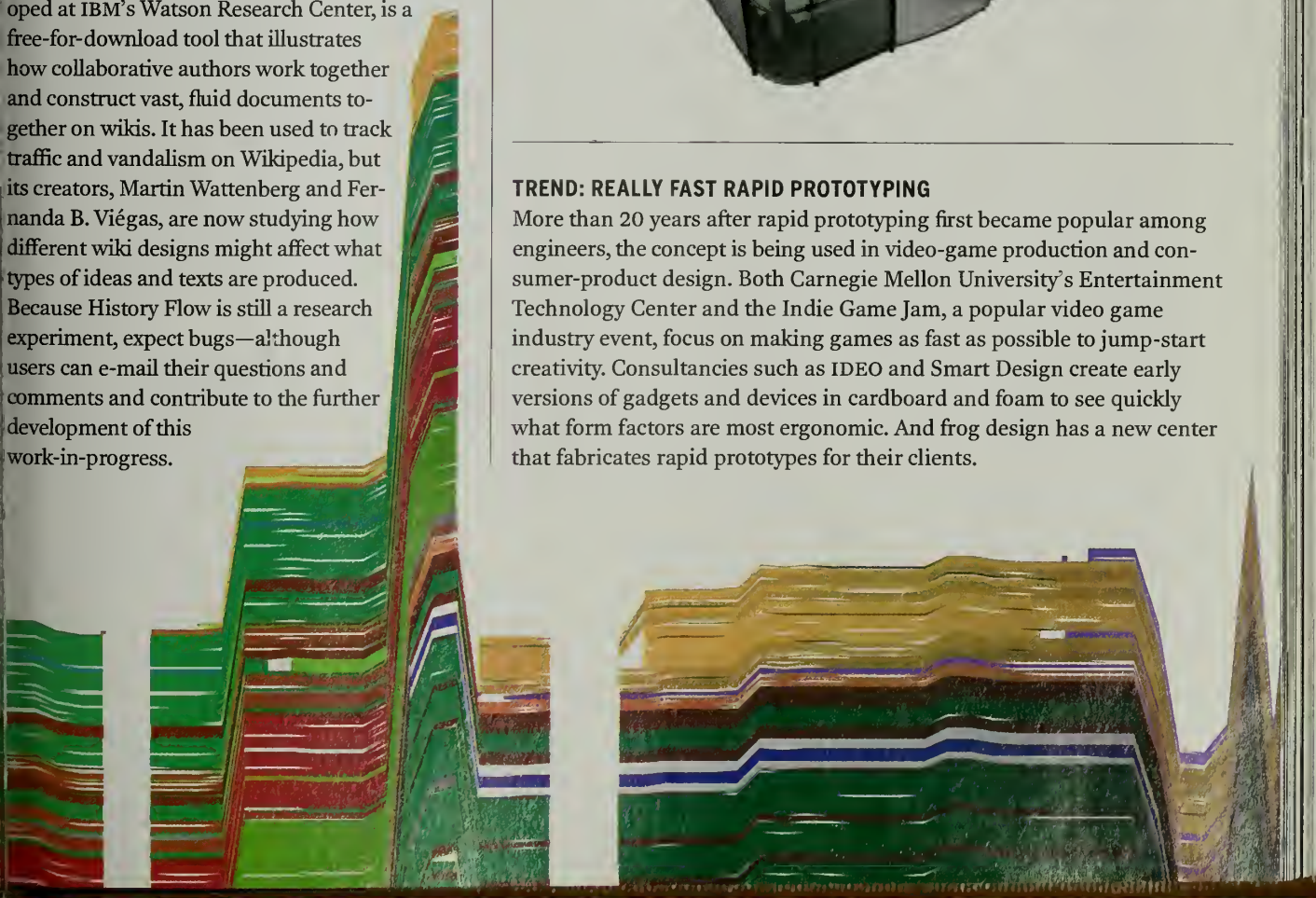
In the age of telecommuting, creative companies are reinventing the office to entice employees to work together face-to-face. The Googleplex, Google's Mountain View (Calif.) HQ, features a series of solid, transparent "tents" made of acrylic that offer coveted personal space as well as a sense of, well, transparency. Legendary furniture designer Douglas Ball recently remade the standard office cubicle for Herman Miller. Called My Studio Environments, the system features translucent walls and doors to offer both privacy and openness. A Swedish company, Offecct, has the most radical solution to the generic cubicle: The Cloud, a self-inflating, 215-square-foot fabric bubble, targeted at corporate users seeking an alternative to conference rooms.

Cool Cube: Herman Miller's stylish and efficient remake of the office cubicle

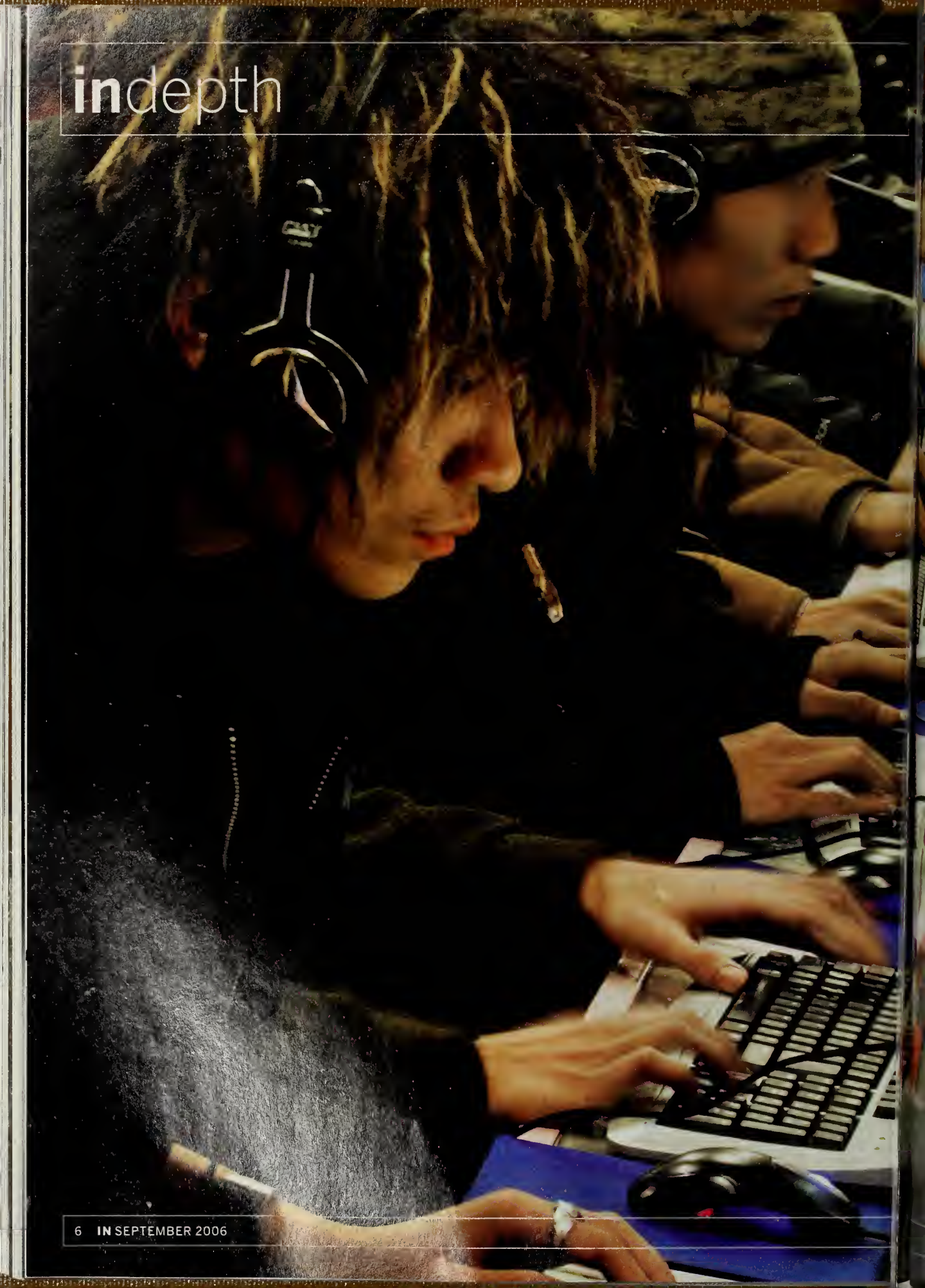


## TREND: REALLY FAST RAPID PROTOTYPING

More than 20 years after rapid prototyping first became popular among engineers, the concept is being used in video-game production and consumer-product design. Both Carnegie Mellon University's Entertainment Technology Center and the Indie Game Jam, a popular video game industry event, focus on making games as fast as possible to jump-start creativity. Consultancies such as IDEO and Smart Design create early versions of gadgets and devices in cardboard and foam to see quickly what form factors are most ergonomic. And frog design has a new center that fabricates rapid prototypes for their clients.





A close-up, low-angle photograph of a person with long, dark dreadlocks wearing large, black over-ear headphones. They are focused on typing on a laptop keyboard. The person is wearing a dark, long-sleeved shirt. In the background, another person is partially visible, also working on a laptop. The lighting is dim, creating a moody atmosphere. The word "indepth" is overlaid in the top left corner.

indepth





## ZIBA DESIGN'S SEARCH FOR THE SOUL OF THE CHINESE CONSUMER

It doesn't get better than this: the research from ZIBA Design for China's biggest computer company, Lenovo. Managers striving to focus on the "fuzzy front end" of the innovation process should take note. At a time when you are launching all manner of ethnographic studies, ZIBA's consumer research for Lenovo is among the best of its breed. It won a 2006 gold Industrial Design Excellence Award (IDEA) from the Industrial Designers Society of America.

Lenovo faces fierce competition in its Chinese home market from Hewlett-Packard, Dell, and IBM, which compete on price and status. Known for its innovative PCs, Lenovo wants to expand its lead in innovation and turned to ZIBA to help. We present here ZIBA's raw consumer research, excerpted from the 2006 IDEA entry kit.

### **Find the Target Consumer: Innovate for Them**

Lenovo asked us to help them define product opportunities for their consumer divisions in desktop, notebook, and cellular so they could better compete on meaning and value. We needed to create an approach that captured the soul of the Chinese consumer and inspired Lenovo's design teams. We needed to create new research tools to find out which design elements have meaning and value for specific groups of Chinese consumers. We provided Lenovo with a 36-month strategic product plan for each of its three consumer technology platforms. Because we were building a strategy, our design research had to

create targets for idea generation and concept refinement.

**Search for the Soul** To create product experiences that connect with China's consumers, the team needed to understand three cultures: China, users, and products. To build these connections, the team developed an approach called "Search for the Soul," which integrates immersive experience (live-the-life), rapid ethnography, and method acting to uncover latent needs and wants.

**Turn Insights into Experiences** By bringing together a mixed group of social scientists, design strategists, and designers, we made sure our insights and ideas stayed aligned. Our design anthropologists uncovered the behavioral, sensory, and reminiscent needs of Chinese consumers. Design strategists packaged consumer insights for the design team, stressed the need for differentiation with competing products, and demanded relevance to the Lenovo brand. Designers worked closely with strategists to visualize the potential of every new product direction and to ensure that consumer insights were captured in exciting new designs.

**Culture Starts Now** Search for the Soul included jump-starting cultural immersion even before the team left for China. We studied the Chinese billboards and had the client send rock, pop, classical, and traditional Chinese music, which blasted in the war room. A professor of Chinese

Internet users at  
cybercafé in Beijing



history was brought in to lecture on key cultural differences between the U.S and China. The team collected Chinese objects of desire—wallets, lighters, and cell-phone holders—and assessed their color, material, and finish properties. To connect with popular culture and messaging, we hired a Chinese exchange student to help interpret lifestyle and technology magazine articles and advertisements.

**Live the Life** There is no substitute for being there. The team split into two smaller groups, and both spent four weeks immersed in three different regions in China. Design anthropologists, design strategists, and industrial designers talked on cell phones as they commuted on bicycle with Beijing workers. They ate from street carts and dined on pig brain and pigeon in large banquet halls. They walked the ancient Hutong alleyways and sang late at night in karaoke bars. Observations and issues about use behaviors outside of the home were noted as the team rode buses and trains, wrote text messages in nightclubs, and used notebook PCs in Starbucks. Visual inspiration was drawn from fashion boutiques and electronics stores, from traditional gardens and modern architecture.

**Find the Target** The team leveraged demographic information from Lenovo on desktop PC, notebook, and cell-phone consumers. The team had to target the right psychographic group as well, given that Lenovo was looking to create platforms that would not just create buzz and die with early adopters but would achieve mass-market adoption and enhance brand image. The team developed psychographic screening criteria to target the “fast followers,” who are the first consumers to buy based on benefit rather than newness.

**Home Visits** Rapid ethnographies were conducted in users’ homes. The team toured areas of work, relaxation, sanctuary, and socializing in each household. We went into closets and gained an understanding of users’ fashion tastes. We hired a native interpreter. Nonverbal, visually engaging tools helped users communicate more freely, revealing thoughts and emotions.

To understand how users live and use technology, we developed an approach that let us squeeze two days of observation into two hours. Prior to the interviews, participants were given a camera, a glue stick, and two poster boards. We asked them to photo-document a week-day and weekend or leisure day, giving special attention to moments when they integrated technology into their routine. These visual time lines let us into their daily behaviors and emotions.

To identify opportunities for product integration (for example, a laptop that’s also a TV), we created a tool called MatchMaker. MatchMaker puts people in a defined-use scenario and lets them explore which products (depicted as icons) they would use in particular circumstances. When users chose multiple devices, MatchMaker helped us identify opportunities for convergent devices.

We developed a concept-building model to define and understand what people want in terms of features and benefits. Features were grouped into categories such as space-saving, entertainment, input, and communication. Our goal was to uncover why users gravitate to certain categories and features.

After each rapid ethnography, the team used a brief download session to check their impressions against the client’s understanding of Chinese culture. This approach helped our client understand our generative and qualitative methods, and it helped us improve our knowledge of Chinese culture.

Ziba researchers immersed themselves in the daily lives of their subjects, dining on pig brains and pigeon, walking ancient Hutong streets, and riding on Beijing’s buses and trains

**Cultural Immersion Through Images** In China, the team collected images of furniture, cosmetics, fashion accessories, cars, and architecture. Back in the U.S., we launched a Web-based visual study with 400 Chinese consumers (100 for each of four newly identified consumer segments) to help inform the direction for the products’ visual expressions. We cropped the images so users would focus on the forms and details themselves rather than on associations with the brand or actual use of a recognizable object. The study asked users to match the diverse forms, details, patterns, and colors to the desired product attributes that had been identified for their particular user group. The study identified patterns in how Chinese consumers visually interpret product attributes.

**Benefits, Not Features** The goal of the evaluation was to determine how design could benefit Chinese consumers. The goal was not to determine a single direction but to identify which design elements are valuable. One-on-one qualitative evaluations were conducted with 40 consumers (10 per segment). The team identified four key benefits that people wanted from technology products. For example, we asked each user to rank the importance of “connecting with my friends” vs. “staying up on the latest business trends.” Making reference to models and sketches, the participants chose those concepts that best matched the benefits they sought and the design details that were driving their impressions.

**Cultural Insight** We learned that consumers in China generally do not make impulse purchases of large items. Rath-

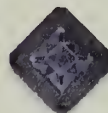
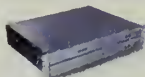


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making large purchases (such as technology products) is a highly involved and researched decision-making process. The team used this knowledge to help elicit detailed feedback on product concepts. By asking consumers which concept they would be most interested in purchasing, then asking which design elements contributed to their positive or negative ranking, the team got a second read on how the concepts delivered benefits through different design configurations.

#### Find Visual Gaps in a Saturated Market

The team first tried mapping Lenovo's and its competitors' offerings on a two-by-two matrix, but this approach failed. Competitive desktops, notebooks, and cell phones, in particular, had run the gamut of visual expressions. The team switched lenses and instead developed a new tool for visual analysis: MediaMapping. Research in China revealed that users see value in convergent devices (desktop PCs, notebooks, and cell phones) for their ability to help them perform specific media activities, such as gaming, photography, watching videos, and reading. MediaMapping allowed our team to identify visual cues that current Lenovo and competitive offerings were using to communicate proficiency in a particular media activity.

**Move from Everyday People to Aspirational Tribes. Innovate for Their Needs** When the team returned to the war room, they distilled the visual worksheets, photographs, and observations from each interview into a single Ethnography Inspiration Sheet. These sheets use pic-

The team identified five distinct technology tribes, each with different aspirations: Social Butterflies, Relationship Builders, Upward Maximizers, Deep Immersers, and Conspicuous Collectors

tures and captions to highlight emotionally the key needs of each user group and to expose the top observations and challenges each user faced. The Ethnography Inspiration Sheets were bound for the client, to give a raw, visceral view into the current market.

To connect emotionally with consumers, you can't just design to their current baseline needs—you also need to connect with their aspirations. Using the Inspiration Sheets as the foundation, the team began to identify the aspirations, behaviors, and needs of distinct clusters. These clusters became known as "technology tribes."

The five technology tribes identified were: Social Butterflies, Relationship Builders, Upward Maximizers, Deep Immersers, and Conspicuous Collectors. Each of these groups has vastly different needs, ranging from the need to connect to a broad social network (Social Butterflies) to the desire to seek escape through fantasy and immersion (Deep Immersers). These profiles gave us a creative springboard for concept generation and filters for evaluating concept relevance. Our creative team worked with Lenovo to gauge the size of each market segment.

To drive concept generation, the team used method-acting techniques to understand how, for example, a Social Butterfly would use a cell phone compared with how a Deep Immerser or a Relationship Builder would do so. Search for the Soul led to a clear understanding of who Lenovo's target consumers ought to be (four primary tech tribes: Social Butterflies, Relationship Builders, Upward Maximizers, and Deep Immersers) and laid the groundwork to create product-line strategies for Lenovo's desktop, notebook, and cellular platforms.

**Deliver Actionable Insight** The purpose of the evaluation was not to select a single product for each platform but to build insight into how users read benefits.

The insights had to be actionable for the design team. We emphasized the need to communicate insights in the context of design elements. The result was a strategy that uses research-based insight to communicate visually the desired product benefits. If the team and the client wanted to enable Deep Immersers to escape into immersive fantasy games on their cell phones, the deliverable highlighted the appropriate design elements. Each concept was evaluated for its ability to communicate benefits to the consumer.

**Understand, Then Innovate** Our research produced a desktop PC for Deep Immersers, a notebook/tablet PC for Relationship Builders, and a cell phone for Upward Maximizers. The products address the unique needs of specialized customer tribes. The modularity of the multimedia desktop PC enables users to easily modify and upgrade their systems. The notebook/tablet PC makes sharing content with friends easy for Relationship Builders. The cell phone has a PDA and camera, giving Upward Maximizers the chance to multitask.

The definition of rich, psychographic tribes gave Lenovo's senior management and marketing teams a common language and a common vision of the future. Our research gave them a defined segment map (based on behavior, attitudes, and values) to guide the development of appropriate products for target consumers. Future product lines are now organized around the needs of specific "tech tribes." Our research gave Lenovo an understanding of Western approaches to creativity and markets. Within months of the completion of this project in 2005, Lenovo cemented its commitment to high-value design by acquiring IBM's PC (ThinkPad) business unit.

So that's how great consumer research is done. Can your company match it? **IN SERVICE**



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## Recognizing Tomorrow's Hot Ideas Today

**S**troll through any corporate innovation conference and one thing becomes abundantly clear: It's a good time to be an innovation guru. Such experts are playing to packed houses, evangelizing the power of user-driven design, the importance of ethnographic research, and the value of an internal "innovation culture." Corporate managers eagerly soak up this "right-brain religion." At some point every consumer product on Earth will be dipped in white acrylic, feel totally ergonomic and embody a whimsical anthropomorphic cuteness.

Then what? Where does the innovation conversation go, say, 10 years from now? To find the next deep wellsprings of innovation, we have to keep an eye on "weak signals," today's fringe ideas that will become tomorrow's common wisdom. Here are a few of them:

### EMBRACING ECOVATION

A revolution in systems ecology, material science, and biology is unravelling how engineering happens in the natural world. Think of the Great Barrier Reef. It was created at near-room temperature, using locally available materials, self-assembly, water-based chemistry, and the power of tides and the sun. "Bio-mimetic" products that copy or are inspired by natural processes are already starting to make it to market. Lotusan Paint, a self-cleaning industrial paint, copies the mechanisms of the lotus leaf, causing dirt and water to bead and roll off. A one-meter-square slice of Synthetic Gecko—recently invented by BAE Systems and

inspired by the material on a gecko's feet—can suspend thousands of pounds.

### PLAYING FOR CHANGE

You may never hire a Chief "World of Warcraft" Officer, but that doesn't mean you won't discover your next business model virtually. Video games are outgrowing their entertainment context and finding new uses as innovation discovery engines. British Telecommunications is using a game called Better Business to help employees learn to manage complex environmental issues. Chanakya is a competitive management simulation played between leading companies in India. (Tata Steel keeps winning). Expect more gamer-managers soon.

### MAKING THE INVISIBLE VISIBLE

Procter & Gamble and Target increasingly look outside for their next breakthrough, so they rely on specialized maps of their innovation networks. The fields of social-network analysis and network cartography are rapidly maturing, allowing companies to visualize who is in their customer base, their supply chain, and their field of influence. Soon, social-network maps will exist in real time and be interactive. Look at an early example at [labs.digg.com](http://labs.digg.com), the R&D development arm of the social-bookmarking site [digg.com](http://digg.com). You'll find two visualizations that show what thousands of people are bookmarking, in real time, as they do so.

### EMBRACING THE ARTS

Today's creative artists can bring power-

ful new modes of thinking to established innovation practices. They also have a healthy disrespect for established boundaries and an ability to find opportunities that traditional approaches miss.

Mythic innovation hubs like Xerox Palo Alto Research Center decades ago paired visual artists and core researchers. These teams reaped insights into the future of computing that shape how we use those technologies today. Now, Web sites such as [we-make-money-not-art.com](http://we-make-money-not-art.com) are cataloging the best artists as they rethink the possibilities of robotics, global positioning systems, and new media. Tomorrow's innovation leaders will be those who can learn to recruit and integrate artistic talent most broadly.

### THE COGNITIVE CONNECTION

While bioscience and nanotech grab the headlines, cognitive science is unlocking the deeper neural bases of our creativity, risk tolerances and views of innovation.

Researchers at the University of Warwick's Institute for Applied Cognitive Science recently developed new brain-based models for understanding how we process risk and use memories to evaluate risks. At USC's Institute for the Study of the Brain and Creativity, neuroscientists are diving into the neurobiological underpinnings of governance, education, economics and aesthetic creativity. By 2015, expect to see more innovation "field" consulting by applied cognitive scientists, who will use cognitive insight to tweak innovation teams and process based on members' cognitive styles.

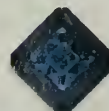
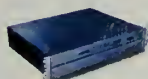


NEC LCD Display

## How do you turn a captive audience into a captivated audience?

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SERVICES AND SOFTWARE ENTERPRISE NETWORKING AND COMPUTING SEMICONDUCTORS IMAGING AND DISPLAYS



in design

MATT VELLA

# Pure Expression



The rise of the designer in corporate culture is shaking old hierarchies. Design is taking its place among classic disciplines such as engineering, finance, marketing, and human resources. But the innovation that designers bring to established corporations pales in comparison with the changes wrought when they design entirely new business models. Enter the designer-cum-automobile entrepreneur.

Henrik Fisker, a 37-year-old Danish-born car design wunderkind, surprised everyone two years ago when he walked away from one of the most coveted jobs in the auto industry, Design Director for Aston Martin and Director of Ford's Global Advanced Design Studio. What colleagues saw as reckless abandon, Fisker knew to be a move toward expression untethered.

This spring, Fisker unveiled the product of his newfound freedom,

two new cars from an all-new company, Fisker Coachbuild. With the Latigo and Tramonto models, Fisker not only pushes the limits of auto design but also reinvents the business of high-profit, low-volume cars.

Fisker, along with partner Bernhard Koehler, the new company's COO, is reviving the art of coach building. The practice of mating mechanically complete car chassis with highly customized bodies was widespread from the 1930s to the 1950s, until the aftereffects of the Depression and World War II took their toll on brands like LeBaron, Derham, and Fleetwood.

Fisker argues that major automakers are burdened by creativity-crushing development costs and bureaucracy. What often stands between craft and greatness is design by committee, death by 1,000 cuts.

By using high-end platforms from BMW and Mercedes-Benz, Fisker

can focus nearly all efforts on ravishing design. The \$182,000 Latigo, for example, is built on the BMW 650 Ci Series, while the \$234,000 Tramonto is mated to the SL55 AMG chassis. The stock bodies and interiors of those base models, or "mules," are gutted to make way for Fisker's complete redesigns. Fisker's customers buy their sacrificial mules, registering them as they would any other car. The vehicles are then shipped to production facilities in Turin, Italy.

There, the interior is tailored specifically to customers' tastes. The seats are entirely remade, endowed with a sartorial elegance that stands out even among the famously handcrafted interiors of Bentley, Rolls-Royce, and Maybach. A new, carbon-fiber body is then fitted to the underlying car's pickup points, the joints where body and chassis metals meet. Extra body panels are

made for each vehicle sold, should an accident, ding, or scratch ever mar the precious exterior.

The supercar market is expected to double in size, to \$6 billion, in the next decade. It is populated by many small shops, such as Saleen and Koenigsegg, all producing high-powered dream cars. Yet Fisker's creations differ substantially. For one, their mass-market underpinnings are street-legal and worthy of everyday use. Other tailor-made autos are track-only, built for race-car performance. Fisker's sales pitch focuses on design, not just performance.

Indeed, of the 70 Tramontas and 50 Latigos already sold, less than 20% have been ordered with an optional ultrahigh-performance package. And, at the \$200,000 price point, it isn't for lack of customer means. "Our customers are self-confident," Fisker explains. "They've already made it. They don't have to prove themselves to anybody. It's about buying something they think is precious, like a piece of art."

Although average consumers may never have heard his name, Fisker commands unparalleled respect among his peers in the auto industry, designers and enthusiasts in particular. To them, Fisker is the equivalent

of architect Frank Gehry or Rem Koolhaas, moving the needle with each new design. Scott Painter, the prolific auto entrepreneur who has founded 10 auto-related companies including CarsDirect.com, gushes unapologetically. "Henrik is the most talented car designer living. Period. Even before, he managed to be unconstrained by the system."

Fisker's previous work helps him rope in loyal customers. His landmarks BMW Z8 and Aston Martin DB9 garnered wide industry praise and a fanatic customer following. Geoff Velazco, automotive designer at BMW's Designworks studio, worked with Fisker and says: "People are going to remember those cars long before they remember who did the Ford Taurus. They're simply iconic." He adds: "Then and now, his cars are classics."

Fisker's designs achieve a balance, donning unabashed masculinity without displacing the anima that makes it possible to fall in love with a machine in the first place. The Tramonto's anthropomorphic headlamps, for example, stabilize its audacious, smirking maw. The Latigo's front hood manages to amalgamate geometric surfaces with organic lines.

Fisker's design works out a complicated thesis about authenticity and beauty. "I make a car just because I like it, and I'm not afraid to say that. That's pure, not the product of a huge marketing group creating on the basis of what it thinks you and a million other people need."

The past hasn't produced many successful role models for Fisker. The automotive timeline is littered with failed boutique ventures. Perhaps the most famous example is John DeLorean. Fisker execs say that they will be different. Their proprietary building process affords them the highest margins of any company in the car industry. So far, Fisker Coachbuild has sold 140 models. "Frankly, we needed less than half that number to break even," says Cristina Cheever, vice-president for marketing and communications.

Fisker also has an ace up its sleeve, one that others before him never had. He says that his fledgling company has been approached by mass-market manufacturers to produce one-off designs for hire. That could provide valuable capital during lean times. Or it might be a way to scale Fisker Coachbuild's already innovative business model.

Henrik Fisker's designs for big carmakers include the BMW Z8 (opposite page left) and the Aston Martin V8 (opposite center). The advanced body designs of Fisker Coachbuild's Latigo (opposite center) and the Tramonto (right) are mated to existing platforms, enabling uncompromised design to coexist with the best of world-class engineering.







16 IN SEPTEMBER 2006

## THE TRUTH ABOUT BRAINSTORMING

We've all sat through meetings designed to spark exciting new ideas only to be disappointed by their boring, obvious mediocre output. So fruitless and frustrating is group brainstorming that many managers say the whole effort is pointless.

Maybe it's better to just let individuals come up with ideas on their own.

And maybe not. We asked Robert I. Sutton, a professor at the Stanford Engineering School and co-founder of the Hasso Plattner Institute of Design, for advice. Sutton ([bobsutton.typepad.com](http://bobsutton.typepad.com)) and associate Andrew Hargadon, of the University of California at Davis, do research on innovative organizations. Sutton's next book, *The No Asshole Rule: Building a Civilized Workplace And Surviving One That Isn't*, from Warner, will be out in February, 2007.

Here's Sutton's take on getting innovative ideas out of meetings, plus his Eight Rules To Brilliant Brainstorming.

It is total nonsense to conclude that if you want creativity, you ought to keep your people in solitary confinement where they can't "waste time" listening to and building on the ideas of others.

Here's the problem: Most academic studies of brainstorming are rigorous, but irrelevant to the challenge of managing creative work. They argue that people brainstorming alone speak more ideas (per person) into a microphone during a 10-minute period than those in a group brainstorm. A "productivity loss" of group brainstorming happens because people take turns talking and therefore can't spew out ideas as fast.

But comparing whether creativity happens best in groups or alone is pretty silly when you look at how creative work is actually done. At creative companies, people switch between both modes so seamlessly that it is hard to notice where individual work ends and group work starts. At group brainstorms, individuals often "tune out" for a few minutes to sketch a product or organizational structure inspired by the conversation, and then jump

back in to show others their idea. I recall a brainstorming session at design consultancy IDEO about a cool haircutting device, after which one participant ran off to build it. Drawing a hard line between individual and group creativity is pointless. What really matters is that the two approaches mingle as the creative process unfolds.

Many academic experiments into brainstorming are fake. They usually involve people who have no prior experience or training in group brainstorming. They often are led by undergraduates in psychology classes who are briefly presented a list of "rules" and then instructed to spend 10 or 15 minutes generating novel ideas about topics that they know—and most likely care—nothing about. A common question in these experiments is: "What would happen if everyone had an extra thumb?" This might be fun but isn't a problem that they will ever face.

Contrast this to the real-life brainstorms led by SAP's Design Services Team, where participants care very much about user-friendly software and will use any and all good ideas generated on the subject. These brainstorms have led SAP to develop many clever prototypes and are starting to change the software that the company ships.

Group brainstorming isn't a panacea even when it is done right, and it is a waste of time, or worse, when done wrong. But a broad body of research on teams and organizations, as well as my own observations, suggests that when brainstorming sessions are managed right and skillfully linked to other work practices, they can promote remarkable innovation.

SEE INSIDE FOR RULES >





## DO INDIVIDUAL BRAINSTORMING BEFORE AND AFTER GROUP SESSIONS

Alex F. Osborn's 1950s classic, *Applied Imagination*, which popularized brainstorming, gave sound advice: Creativity comes from a blend of individual and collective "ideation." This means building in time for people to think and learn about the topic before the group brainstorm, as well as time to reflect about what happened after the meetings. When I studied the IDEO team as they developed a new hair-cutting device, engineer Roby Stancel told me that he prepared for the session by going to a local hardware store to look at all kinds of cutting machines—lawn mowers, hedge clippers, and weed whackers—to inspire him before the group session.

3

## BRAINSTORMING SESSIONS CAN BE USED FOR MORE THAN JUST GENERATING IDEAS

Brainstorms are places to listen, learn, and educate. At IDEO, they support the company's culture and work practices. Project teams use brainstorms to get input from people with diverse skills throughout the company. Knowledge is spread about new industries and technologies. Newcomers and veterans learn about who knows what. The explicit goal of a group brainstorm is to generate ideas. But the other benefits of routinely gathering rotating groups of people from around an organization to talk about ideas might ultimately be more important for supporting creative work.

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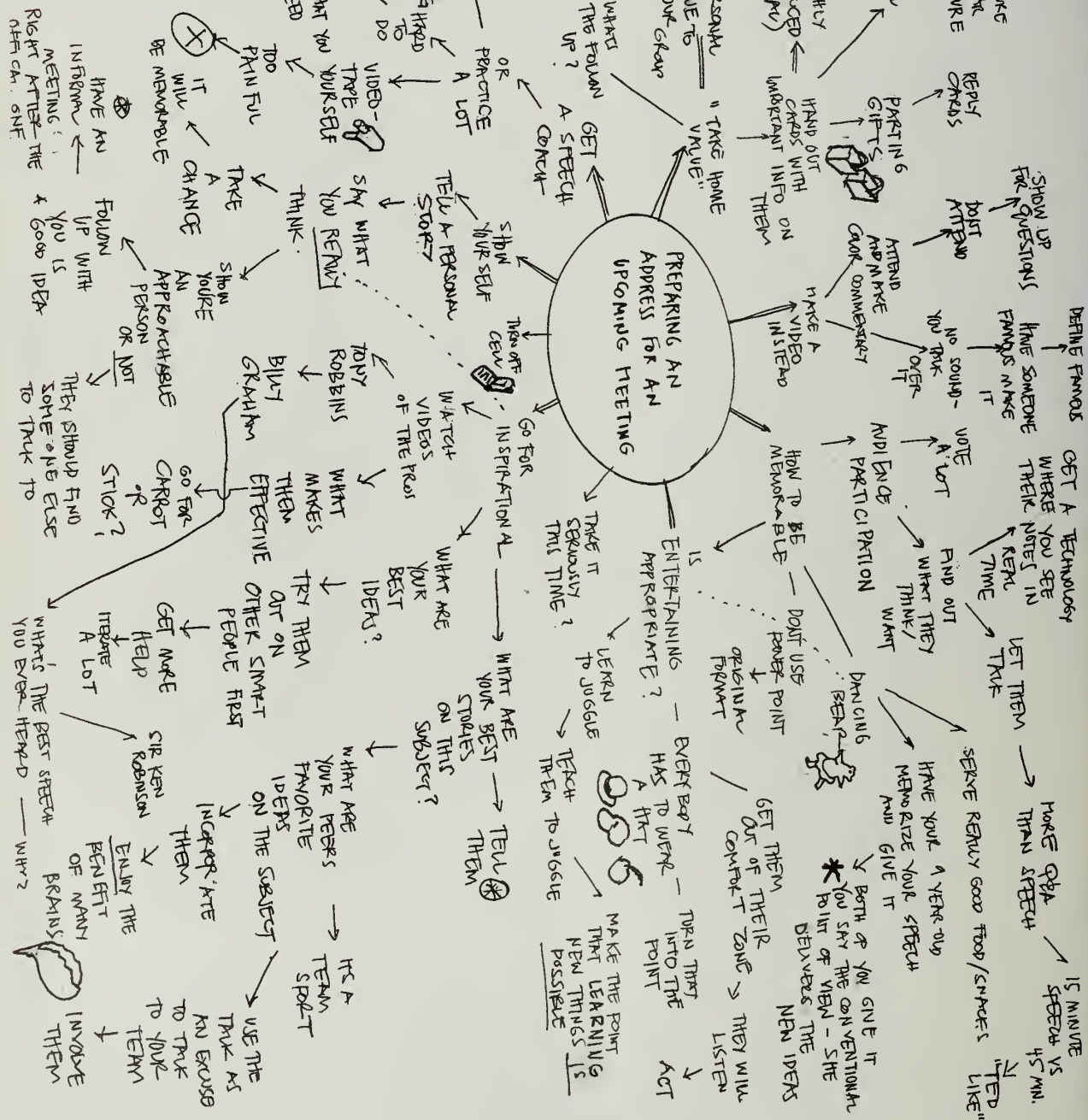
What makes you special?

IBM



Photo: Getty Images





David Kelley, founder of IDEO and the Hasso Plattner Institute of Design at Stanford, uses mind maps to foster creativity. Mind maps are a popular thinking tool in Silicon Valley. Here's why: "When I want to do something analytical, I make a list. When I'm trying to come up with

ideas or strategize, I make a mind map. Mind maps are organic and allow me to free associate. They are great for asking questions and revealing connections between seemingly unrelated ideas. I start in the center with the issue or problem I am working on and then as I

move farther away I get better and better ideas as I force myself to follow the branches on the map and in my mind. The cool thing is that you allow yourself to follow your inner thoughts, which is different than making a list where you are trying to be complete and deal with data.



\* this doctor is examining an aorta.

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# EIGHT RULES TO BRILLIANT BRAINSTORMING

| BY ROBERT I. SUTTON

## USE BRAINSTORMING TO COMBINE AND EXTEND IDEAS, NOT JUST HARVEST THEM

Andrew Hargadon's *How Breakthroughs Happen* shows that creativity occurs when people find ways to build on existing ideas. The power of group brainstorming comes from creating a safe place where people with different ideas can share, blend, and expand their diverse knowledge. If your goal is just to collect the creative ideas that are out there, group brainstorming is a waste of time. You may as well stick to a Web-based system for collecting ideas. Even an old-fashioned employee suggestion box is good enough for this limited task.

1

## DON'T BOTHER IF PEOPLE LIVE IN FEAR

Groups bring out the best and the worst in people. If people believe they will be teased, paid less, demoted, fired, or otherwise humiliated, group brainstorming is a bad idea. If your company fires 10% of its employees every year, people might be too afraid of saying something dumb to brainstorm effectively.

2

## BRAINSTORMING REQUIRES SKILL AND EXPERIENCE BOTH TO DO—AND ESPECIALLY—TO FACILITATE

Not everyone can walk into a room and lead a productive brainstorming session. It is not a job for amateurs. In all the places I've seen brainstorming used effectively—Hewlett-Packard, SAP's Design Services Team, the Hasso Plattner Institute of Design at Stanford University, the Institute for the Future, frog design, and IDEO—brainstorming is treated as a skill that takes months or years to master. Facilitating a session is a leadership skill that takes even longer to develop.

5

## A GOOD BRAINSTORMING SESSION IS COMPETITIVE—IN THE RIGHT WAY

In the best brainstorms, people compete to get everyone else to contribute, to make everyone feel like part of the group, and to treat everyone as collaborators toward a common goal. The worst thing a manager can do is set up the session as an "I win, you lose" game, in which ideas are explicitly rated, ranked, and rewarded. A Stanford grad student once told me about a team leader at his former company who started giving bonuses to people who generated the best ideas in brainstorms. The resulting fear and dysfunction drastically reduced the number of ideas generated by what had once been a creative and cooperative group.

6



## DO INDIVIDUAL BRAINSTORMING BEFORE AND AFTER GROUP SESSIONS

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## BRAINSTORMING SESSIONS ARE WORTHLESS UNLESS IDEAS LEAD TO ACTION

Brainstorming is just one of many techniques that make a company creative. It is of little value if it's not combined with observing consumers, talking to experts, or building prototype products and experiences that provide an outlet for the ideas generated. I've worked with "creative" companies that are great at coming up with ideas, but never implement them. I once studied a team that spent a year brainstorming and arguing about a simple product without producing a single prototype,

even though a good engineer could have built one in an hour. The project was finally killed when a competitor came out with a similar product.

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7

## FOLLOW THE RULES, OR DON'T CALL IT A BRAINSTORM

This is true even if you hold only occasional brainstorms and even if your work doesn't require constant creativity. The worst brainstorms happen when the term is used loosely and the rules aren't followed at all. Perhaps the biggest mistake that leaders make is failing to keep their mouths shut. I once went to a meeting that started with the boss saying: "Let's brainstorm." He followed this pronouncement with 30 minutes of his own rambling thoughts, without a single idea coming from the room. Now, that's productivity loss!

8





\* this car is a key eyewitness.

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resulting fear and dysfunction drastically reduced the number of ideas generated by what had once been a creative and cooperative group.

6

\* this suitcase is worth \$140,000.

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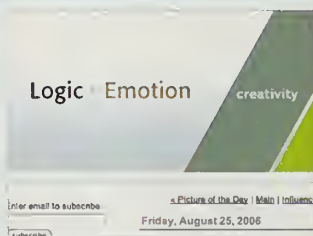
## LOGIC + EMOTION

[darmano.typepad.com/logic\\_emotion/](http://darmano.typepad.com/logic_emotion/)

Digitas creative director David Armano develops graphics to illustrate new concepts for marketing, brands, and experience design. Here he traces bloggers' spheres of influence with overlapping community clusters illustrating social networks and their interactions.

### EXCERPT FROM SITE

Bloggers at each level command a "sphere of influence." The higher the "level," the more people are exposed to a blogger's influence. The degree of influence is mainly related to the quantity (and quality) of the blogs and sites that link back to them. And...a blogger who is well known before they even start a blog has a better chance of reaching the top levels of influence vs. one starting from scratch.... It does represent a "human pyramid." As much as the social media network acts as a great equalizer, you can only influence as many people as you have access to.



## TED BLOG

[tedblog.typepad.com](http://tedblog.typepad.com)

It sees itself as host to the ideas that matter in technology, entertainment, and design (TED), and is tied to the annual TED conference. One of the blog's best features is the TEDTalks videocasts.

### EXCERPT FROM SITE

Gearheads around the world are eagerly awaiting the July 20 arrival of a new electric sports car from a startup by the name of Tesla Motors.... When you think about a sports car as a device focused on pure driving enjoyment rather than as A-to-B transportation, going electric makes a lot of sense.... If all you're going to do is carve up a twisty canyon road on a Sunday morning and drive a loop back home, there's no need to worry about where your next jolt of juice will come from. Second, there's the inherent nature of electric motors, which develop maximum torque at zero rpm.... A torquey electric motor will give you neck-snapping acceleration and a scintillating oomph in the small of your back.

**TEDBLOG**  
Ideas That

[Rick Warren on TEDTalks](#) | [Main](#)

## JIM CARROLL

[jimcarroll.com/weblog](http://jimcarroll.com/weblog)

Carroll is a futurist and trend-spotter. His blog traces his travels about the country as he talks to innovators. Here's a look at what building a sand castle teaches us about innovation.

### EXCERPT FROM SITE

Hierarchy has disappeared: In most cases, there isn't a boss, a reporting structure, or anything else that can cause organizational sclerosis. People just pitch in and do what needs to be done. The lack of a hierarchy is implicit to most successful teams. Creativity is implicit: Anyone can build a sand castle. There are no rules or preconceived notions, other than some sand and water. The same thinking should drive corporate innovation efforts....

Experience doesn't cloud insight: Parents listen to kids. Kids get bored and move on to another rampart and do something awesome. The key to sand-castle building is the combined insight of several different generations.



## INNOVATION TOOLS

[innovationtools.com/weblog/innovation-weblog.asp](http://innovationtools.com/weblog/innovation-weblog.asp)

This site covers innovation research, best practices, strategies, management, and how businesses use blogs for idea creation and collaboration.



### EXCERPT FROM SITE

In their new book, *Mavericks at Work: Why the Most Original Minds in Business Win*, authors William C. Taylor and Polly LaBarre offer some fascinating perspectives and case histories on the topic of open-source innovation.

What is open-source innovation? Its central idea is that companies will succeed at innovation in the 21st century by attracting ideas from the brightest minds anywhere, not just within the organization's four walls. Open-source software, where thousands of programmers collaborate to write software that is arguably better than any one company could have developed on its own, is a great example of it in action. The most notable example of this, of course, is the Linux operating system.

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## WHO IS JONATHAN IVE?

BY PETER BURROWS

# THE MAN BEHIND APPLE'S DESIGN MAGIC

Last spring, an eclectic mix of designers thrilled an auditorium full of their peers at a conference called Radical Craft, put on by the Art Center College of Design in Pasadena, Calif. Fashion designer Isaac Mizrahi told inspiring stories of his rise to fame. Artificial intelligence pioneer Danny Hillis showed off a topographical computer display that could render anything, even the Himalayas, in three dimensions. Dutch inventor Theo Jansen brought one of his VW-size "beach creatures" made of plastic PVC tubes that "walked" across the stage like some George Lucas-inspired interstellar crab.

But the headliner of the show made a decidedly less showy impression. Shambling onto the stage with a nearly shaved head and dark T-shirt, Apple Computer Senior Vice-President for Industrial Design Jonathan Ive looked like

a grad student who had gotten lost on the way to Starbucks. The 39-year-old Brit slouched unfabulously in his seat and quietly answered questions from conference host and award-winning editor, Chee Pearlman. Despite countless invitations, he refused to trumpet his own design prowess or to dish on what it's like to work with his perfectionist boss, Steve Jobs.

The man who, after Jobs, is most responsible for Apple's amazing ability to dazzle and delight with its famous products, chose instead to talk about process—what he called "the craft of design." He spoke passionately about his small team and how they work together. He talked about focusing on only what is important and limiting the number of projects. He

spoke about having a deep understanding of how a product is made: its materials, its tooling, its purpose. Mostly, he focused on the need to care deeply about the work.

None of this was very glamorous, especially for a famous designer. There was nothing newsworthy, few concrete details of anything. No doubt, that's in part because Ive is a reluctant celebrity, and also because of the secrecy that Jobs imposes on all things Apple. In fact, Ive wouldn't talk for this story. Neither would others, fearing Apple's ire, including the Royal Society of the Arts in England, which helped give Ive his start 20 years ago. Apple talks to the outside world on its own terms—typically at new product launches,



such as the well-hyped press event on Sept. 12.

Yet Ive's interview onstage revealed what many people close to the company say is indisputable—that he is Apple's Man Behind the Curtain. While Jobs sets the direction and provides the inspiration, Ive melds Apple's unique creativity with the nuts-and-bolts required to make beautiful things. Apple's innovation success is due greatly to this alchemy between chief designer and powerful boss. "I think Steve Jobs has found somebody in Jony who knows how to complete or even exceed his vision, and do it time and time again," says Pearlman.

Since it began nine years ago, the "Steve & Jony Show" has cranked out a stream of iconic products, from the candy-colored iMac that changed the world's conception of a home PC in the late 1990s to the diminutive iPod Nano. In that time, Apple has created and maintained a choke hold on the digital music market, and analysts say it is poised for its biggest share gains in the PC market in years. The lessons from the 232% rise in Apple shares over the past 10 years transcend any particular tech market. Apple has put the design of great customer experiences on the map, not just as a means to win creative kudos but as a way to earn billions of dollars and revolutionize industries. "Apple's big contribution is showing that you can become a billionaire by selling emotions, that design can be a valid business model," says Gadi Amit, founder of NewDealDesign, a product design boutique in San Francisco.

There is no doubt that Jobs himself is Apple's most unique weapon when it comes to innovation. While he comes off like a rock star, laying down power chords for Apple's adoring fans at those dramatic product intros, he's as committed to perfection as any Swiss watchmaker. This is a guy who once insisted that a shipment of fine Italian marble for Apple's first Manhattan retail store be sent to Cupertino, Calif., so he could inspect the veining in the stone. And while designers elsewhere must fight off the cost-cutters, at Apple everyone knows their employment depends on living up to Jobs's high standards. According to one story, possibly apocryphal, Jobs once demanded that a designer of a new Mac not allow a single visible screw.

When the designer built a prototype that had one screw, tucked out of sight under a handle, Jobs fired him. "Apple is the most design-savvy company in the world, and it's because of Steve Jobs," says Ray Riley, a former Apple designer who now runs Nike's Advanced Innovation Div.

Ive says he and his boss speak at least once a day. In fact, their lives are very much part of the same fabric. Despite great fame and fortune, both manage to guard their privacy. Ive lives with his wife, a historian he knew growing up, and their young twins in a house "with not a hint of ostentation," says Clive Grinyer, Ive's first business partner. Jobs, for all his self-promoting skills, lives a relatively quiet life as well. He owns no vacation houses and rarely shows up to Silicon Valley social and business events. The sneakers, the T-shirts, and Issey Miyake turtlenecks that he sports are not only for dramatic effect—he likes the informal style, as do Ive and his team of designers.

But if Jobs is the public keeper of Apple's design zeitgeist, then Ive is the private leader of its talented design team. "Apple is a cult, and Apple's design team is an even more intense version of a cult," notes Riley. Actually, it's not a big cult—just a dozen people or so. But they operate at an extremely high level, both individually and as a group. Ive has said that many Apple products were dreamed up while eating pizza in the small kitchen at the team's design studio.

It's a team that has worked in idyllic comfort for many years. Some designers were at the company long before Ive arrived in 1992. They rarely attend industry events or awards ceremonies. It's as though they don't require outside recognition because there isn't any higher authority on design excellence than each other, and because sharing too much information only risks helping others close the gap. And they personally reflect the design sensibilities of Apple's products—casually chic, elitist and with a definite Euro bent. The team, made up of thirty- and fortysomethings, has a definite international flair. Members include not only the British Ive but also New Zealander Danny Coster, Italian Daniele De Iulio, and German Rico Zörkendörfer. "Its good old-fashioned camaraderie—everyone with the same aim, no

egos involved," says British fashion designer Paul Smith, a friend since the late 1990s when Ive sent him a new iMac. "They have lots of dinners together, take lots of field trips. And they've turned these gray frumpy objects called computers into desirable pieces of sculpture you'd want even if you didn't use them."

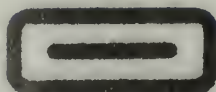
Most of Ive's team live in San Francisco, and rumor has it that the starting salary for the group is around \$200,000, some 50% above the industry average. They work together in a large open studio with little personal space but great privacy. Many Apple employees aren't allowed in, for fear they'd catch a glimpse of some upcoming product. A massive sound system pumps up the music. Ive invests his design dollars in state-of-the-art prototyping equipment, not large numbers of people. And his design process revolves around intense iteration—making and remaking models to visualize new concepts. "One of the hallmarks of the team I think is this sense of looking to be wrong," said Ive at Radical Craft. "It's the inquisitiveness, the sense of exploration. It's about being excited to be wrong because then you've discovered something new."

Ive's team at Apple isn't the usual design ghetto of creativity that exists inside most corporations. They work closely and intensely with engineers, marketers, and even outside manufacturing contractors in Asia who actually build the products. Rather

than being simple stylists, they're leading innovators in the use of new materials and production processes. The design group was able to figure out how to put a layer of clear plastic over the white or black core of an iPod, giving it a tremendous depth of texture, and still be able to build each unit in just seconds. "Apple innovates in big ways and small ways, and if they don't get it right, they innovate again," says frog design founder Hartmut Esslinger, who designed many of the original Apple computers for Jobs. "It is the only tech company that does this."

What does this mean for the long list of companies now trying to lift their own design games, such as Dell, Hewlett-Packard, and Microsoft? They have some reason to hope. As long as Apple focuses on so few products and relies so heavily on so few individuals, it can address only so many markets. "Apple doesn't have a model that scales," insists HP design chief Sam Lucente. And, barring any new breakthroughs on Sept. 12, Apple's current visual vibe—white boxes—is now five years old and getting predictable.

Yet most big corporations have neither the focus, the skills, nor the appetite for risk to build mass-produced products that feel as if they were made by high-priced boutiques in New York or London. While computer companies have focused on pinching pennies these past few decades, Apple has been perfecting its design game. The fact that rivals are now







### WHY YOU REALLY LOVE YOUR IPOD

What makes the basic iPod so irresistible? It isn't just what entirely obvious. Yes, the design is beautiful and the operation is intuitive. But the true magic comes from a slew of factors just below consumer perception.

#### 1 Materials

Take a close look at your iPod. Notice there's a clear layer of plastic above the white. This is called "co-molding" and gives the product depth—and costs plenty to tool and produce in high volumes.

#### 2 Fit and Finish

Most tech products have big gaps where pieces of plastic or metal come together—typically a quarter of a millimeter or so. Not Apple. It's "part lines" are truly lines, not gaps.

#### 3 Screws

While other products often have recessed holes where the screws fit in, the iPod doesn't. In fact, it doesn't even have visible screws.

#### 4 The Boiler-Plate

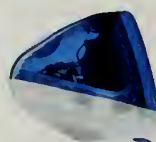
At most companies, the manufacturing boss insists on slapping a big sticker with the serial and bar codes and regulatory stamps of approval. On the iPod, it's elegantly etched on the bottom of the back side of the device.

### IVE'S ICONS

Not all of his products have rocked digital culture, but many are considered masterpieces by the designati



1994  
APPLE NEWTON MESSAGEPAD 110



1998  
iMAC



2001  
iPOD



2001  
TITANIUM POWERBOOK G4



2004  
iMAC G5

talking about design is not proof they're catching up—but of how far they have to go.

Ive had his own ideas from the start. Born in a middle-class London neighborhood, he was consumed with the mystery of how things are made by his early teens. Upon enrolling in the design program at Newcastle Polytechnic in 1985, his talent and drive quickly became obvious. During an internship with design consultancy Roberts Weaver Group, he created a pen that had a ball and clip mechanism on top, for no purpose other than to give the owner something to fiddle with. "It immediately became the owner's prize possession, something you always wanted to play with," recalls Grinyer, a Roberts Weaver staffer at the time. "We began to call it 'having Jony-ness,' an extra something that would tap into the product's underlying emotion."

By the time he graduated, Ive was already something of a legend in British design circles. Grinyer visited him once in his flat in the very tough Gateshead section of Newcastle and was shocked to find it filled to the rafters with hundreds of foam models of Ive's final project, a microphone and hearing aid combo that teachers could use to communicate better with kids with hearing problems (not surprisingly, in white plastic). "I'd never seen anything like it: The sheer focus to get it perfect," recalls Grinyer.

Ive ended up winning the student's award for design from the Royal Society of Arts, not once but twice. The first was for an automated teller machine, commissioned by the sponsor of the contest, Pitney Bowes. That got him airfare to a brief internship at the Stamford-(Conn.) company, but Ive soon hopped a flight to California to make the rounds with up-and-coming design firms in Silicon Valley. Robert Brunner, then with Lunar Design, was floored when Ive showed him an elegant question mark-shaped phone—not just a foam block but an actual model with all the internal components machined separately. "It wasn't just that the product had heart, but it was engineered; he was thinking about how to make it in volume," recalls Brunner.

After graduating, Ive joined Grinyer in 1989 in a

London startup, Tangerine Design. But he couldn't get British companies to appreciate his work. When a company mothballed a bathroom sink he'd spent months working on, "he was dejected and depressed," says Grinyer. "He had poured himself into working for people who really didn't care." Ive admits he wasn't cut out to be a design consultant, where salesmanship is the most essential skill. "I was terrible at running a design business, and I really wanted to just focus on the craft of design," he told Pearlman.

So in 1992, he headed west to find a new life with Apple. By then, Brunner had become chief of Apple's design team. He had previously given Ive work at Tangerine to help visualize the future of its new PowerBook laptop PC line. Now he offered Ive a permanent job in Cupertino. Those were the lean years before Jobs returned. Not only was Apple hemorrhaging money and market share, but it was the whipping boy of Wall Street and the business press. "Through some sort of reckless sense of faith," said Ive at Radical Craft, he accepted Brunner's invitation.

From the start, Ive won his share of accolades. He designed the first PDA to run Apple's short-lived Newton software. But by the time he replaced Brunner to become Apple's design chief in 1996, Apple was in deep trouble. Ive, then only 29 years old, struggled to fight off the cost-cutters as best he could. They carted off the beloved Cray supercomputer Apple's designers had used to simulate the performance of dreamed up products. And Apple's products began to look as boring as everyone else's. Ive was still able to bring in a few talented young designers and maintain morale. Former Apple designer Thomas Meyerhoffer, one of the new hires, says: "Jonathan never stood on a chair or made any speeches. But if he hadn't believed we could do it, we wouldn't have believed it."

On July 9, 1997, Jobs returned from exile and took Apple's reins from ousted CEO Gilbert F. Amelio. Ive nearly didn't survive the initial turmoil as Jobs quickly set out to remake the company, say two of his colleagues. As Jobs axed all but four of Apple's sixty-odd products, he scoured the globe to hire a true design superstar. He called on Richard Sapper, who did



the IBM Thinkpad laptop, car designer Giorgetto Giugiaro, and architect/designer Ettore Sottsass.

But just as Ive was dusting off his resume, Jobs, with a tremendous eye for talent, recognized that he already had what he needed. And as Jobs imposed his own design standards, Ive became the beneficiary. "Steve Jobs is a tyrant, but that's precisely what Apple needed," said usability expert and author Donald A. Norman, even though he was one of the thousands who were pushed out in those early days. "Jobs said: 'This is the direction we're going,' and he unleashed Jonathan to make it happen."

The synergy between the two set off an explosion of great Apple products. It started with the first iMac. Determined to recast the PC as something fun rather than forbidding, Apple created a friendly, all-in-one model encased in a deep blue, translucent shell. Insiders say that Danny Coster, an affable New Zealander, did most of the design with Ive's close collaboration.

To understand how to make a plastic shell look exciting rather than cheap, Ive and others visited a candy factory to study the finer points of jelly bean making. They spent months with Asian partners, devising the sophisticated process capable of cranking out millions of iMacs a year. The team even pushed for the internal electronics to be redesigned, to make sure they looked good through the thick shell. It was a big risk for Jobs, Ive, and Apple. Says one rival: "I would have had to prove that transparency would increase our sales, and there's no way to prove that." He figures Apple spends as much as \$65 per PC casing, vs. an industry average of maybe \$20.

In 2001, Apple unveiled the first computer made out of titanium. The backstory: Ive let Danny De Iulius and two other team members sneak thousands of dollars worth of computers to set up shop in a San Francisco warehouse, far away from Apple's main campus. They worked there for six weeks on the basic design and then headed off to Asia to negotiate widescreen flat panels and to work with toolmakers. The result: a clean, post-industrial look that marked the end of the more whimsical design language of the original iMac. In October of that year, Apple unveiled the iPod, which immediately set the standard for cool in digital music players—not just because of the iPod itself but

because of the way it worked seamlessly with Apple's iTunes jukebox software and online store.

That integration is a major part of Apple's design magic. Thinking about "design" as simply style or fashion misses the point. The original iMacs were clearly retrospective nods to the Jetsons school of design. And the white, clean "look" of the iPod is "very derivative of central European design from the late 1960s and early '70s," says NewDealDesign's Amit. Compare many Apple products to the work of Dieter Rams, chief designer at Braun, and "you'll see that it's almost verbatim," he says.

What really sets Apple's products apart is the "fit and finish," the ultimate impression that results from thousands of tiny decisions that go into a product's development. Take Apple's pioneering work in injection molding. It's part science, part art, and plenty of trial and error. The process involves figuring out how to inject molten plastic or metal through tiny "feed lines" into an irregularly shaped cavity, and then having just the right amount of holes so that it cools to a blemish-free perfection in seconds.

Ive's team understands and respects this process of production so much that toolmakers and suppliers in Asia prefer working with them—despite the fact that Apple is a ferocious negotiator on cost. Suppliers get a jump on the future by working with Apple, since it is setting the design pace.

Of course, Apple makes mistakes. Among the problems of the Apple G4 Cube, discontinued in 2000 after less than a year, was the appearance of cracks in its thick, clear enclosure. The company also faces lawsuits about scratching of the iPod nano. And while its iBook and PowerBooks were creative triumphs, Apple recently had to recall 1.8 million units that had potentially faulty batteries.

These misses are dwarfed by Apple's remarkable consistency as a high-tech hitmaker. And Ive, who recently received the Commander of the Most Excellent Order of the British Empire (CBE), is a major reason why. No doubt, such musty-sounding honors cause some rival designers to joke that Ive is past his prime. Not likely. So long as Ive has that close-knit team and that hard-driving boss, the Steve and Jony should continue to roll along just fine. **IN**

**LESSONS ON DESIGNING INNOVATION  
FROM AN INTERVIEW WITH APPLE'S JONATHAN IVE AT THE RADICAL  
CRAFT CONFERENCE, ART CENTER COLLEGE OF DESIGN**

PASADENA, MARCH 25, 2006

I think one of the things we are good at as a team is gently moving these fragile ideas along a bit so they become just a little more robust and you can actually start to see what they are. So we go from those sorts of discussions and then we just make lots and lots of prototypes. Then we spend a lot of time at the manufacturing sites. We'll be there right to the end when we're in production.

If you are going to design something that's going to be truly innovative, my experience has been that this will require the company that's going to make it to change—often to change fundamentally—in its approach to how it develops products, how it evaluates them, how it makes them, and how it markets them.

We try very genuinely to design products that solve problems. They are not about self-expression. What we are trying to do is design something that when you see it you really wonder if it's been designed at all because it seems so obvious and so inevitable and so simple.

We don't make very much stuff. That's a very important part of our approach to what we do, which is to not do a lot of unnecessary stuff but just to focus and really try very sincerely to care so much about the few things that we do.

We love taking things to pieces and understanding how they are made. We will figure something out that seems relatively interesting and we'll spend some time in Northern Japan talking to the master about how we can form metal in a certain way. As you truly understand that, that obviously informs your design rather than it just being an arbitrary shape.



## Metrics Madness

Quantifying innovation is key. Here's how to do it right and avoid the big mistakes managers often make

**T**he buzz around innovation is expanding to monstrous proportions. Nowhere is this frenzy more evident than in the pell-mell rush to metrics. Where once managers obsessed about measuring quality and cost, they now focus on measuring the innovation process. A wise use of metrics can improve a company's innovation "hit rate," and help companies make the right choices, faster, with less risk of failure.

But metrics madness can lead to confusion, dysfunction, and less innovation, not more. The common mistakes are putting in too many metrics, measuring the wrong things, misaligning metrics within organizations, and counting what can be counted, not what counts. Looking solely at the number of ideas in a pipeline without measuring successful outcomes in terms of revenue and margins won't help.

Metrics can mislead. Whatever gets measured will change. Focus heavily on patents, and soon employee incentive pro-

grams will develop to reward patent generation. For some companies such as IBM, patents do reflect success in innovation. But how many patents do Samsung or Apple Computer hold relative to IBM? Does it really matter to their core strategies?

Which are the best metrics to use? Try an innovation dashboard or index, a portfolio of eight to ten significant measures. More than that can overwhelm; fewer don't provide enough information to be useful. And remember: Executives in the corner suite need a different set of measures than do the people executing design strategy.

Innovation consultants believe that companies should look at metrics holistically, including other measures that add balance for a fuller picture. IN talked with the experts at Booz Allen, Boston Consulting Group (BCG), Jump Associates, and Kaiser Associates to pull together the good, the bad, and the downright ugly on the nascent practice:

### STARTING OUT

**Before you install a massive system of metrics, take the time to study and understand your company's innovation DNA. What resources are available to foster innovation, in terms of money, people, and processes? Your metrics flow from your resources.**

**SPENDING LEVELS** How much money is available for research and development, design and implementation? Is

this amount sufficient? Too much?

**WARNING!** It doesn't do much good to measure spending levels if you don't ultimately track them against final outcomes. It's the organic growth and profit margins that count in the end. Never lose sight of that.

**KEY PEOPLE** The folks that really matter to a process must always be part of it. This is often a group so small that you can call the members out by name and

count them on one hand.

**WARNING!** Focus on building a team of people who can create—and deliver—the product/service. Titles and silos do not matter. Designers, ethnographers, and engineers are key, but people who understand the company culture and can keep new projects on course are needed, too.

**IDEA FLOW** A formal electronic system that manages new ideas provides a vis-

le means of generating and measuring their volume. It can be a useful tool to get employees to contribute.

**WARNING!** Ideas are cheap. What matters most is quality. Companies should look carefully at the screening mechanism they have for sifting the gold from the thousands of suggestions they may get. And be aware that ideas from senior executives often get the green light, not necessarily because they are more innovative.

**KEY CAPABILITIES** Know what you can do and what you can't do. Understand how the systems in your culture work and what your resources are.

**WARNING!** Companies don't do everything equally well. Know your limits and design those hindrances into your strategy. If going through the IT department always means a six-month delay costing \$2 million, deal with it.

## BUILDING THE SYSTEM

Innovation processes must be robust and repeatable. Metrics that measure them must keep your vision on course.

**TIME TO MARKET** Speed is everything. In a recent BCG survey of 269 companies, time to market was the innovation that metric companies reported to be most valuable.

**WARNING!** Managers often make the mistake of citing the average, not the median. It's the median, however, that allows them to course-correct. If all your products reach market, say, after 6 weeks, except one that takes an inordinately long time, it's critical to identify the problematic one and find out why. Similarly, find out why the fastest products are quick to reach shelves, and repeat that process.

**STAFFING AGAINST PLAN** Take an early look at whether or not your innovation projects are fully staffed. If they are 50% staffed, you may be slipping even if you are only two months into a 15-month effort.

**WARNING!** The success of the later stages

depends on the quality and timing of the work up front. This metric relies on a disciplined company culture. A catch-up-later mentality won't work. The measure alone will do no good if managers don't or can't quickly bring projects up to staff.

**MILESTONE PROGRESS** Break projects into discrete, measurable deliverables, and then make sure they are delivered.

**WARNING!** To make it work, companies must hold employees accountable for meeting milestone targets. If your corporate culture allows people to let things slip, the process doesn't work. If a supervisor accepts half-finished projects, it also fails.

**RISK ANALYSIS** Companies' tolerance for risk varies, and understanding those limits is key to placing your innovation bets. To identify risk, some businesses identify 10 to 15 key attributes, such as the number of new technologies involved in a new product or the length of time it will take to bring the product to market.

**WARNING!** Risk is culture-specific for companies. Without analyzing the corporate culture and knowing the tolerance and limits of risk, innovation teams waste their efforts and fail.

## CHARTING PERFORMANCE

Strong metrics that measure outcomes can be best used to drive future performance. They can help convince senior managers to allot more resources to future innovation efforts.

**TOTAL SHAREHOLDER RETURN** TSR is the most used innovation metric. It represents the amount shareholders gain from a rise in stock prices plus dividends. Most innovation consultants argue that companies with a hearty innovation process should see it reflected in their TSR.

**WARNING!** Research on TSR is mixed. Some research points to higher stock returns for companies that focus on con-

sumer experiences and design. Others point out that there is no statistical relationship between how much you spend on R&D and total shareholder return.

**NUMBER OF PATENTS** Measuring the number of patents encourages companies to increase their development of intellectual property. It's one of the only metrics that is publicly available from all companies, so many use it to benchmark their progress against competitors.

**WARNING!** Invention is not innovation, and patents do not automatically lead to innovation. A patent focus can become distracting. Many companies focus on the legal aspects of protection so much that they lose sight of the business.

**PERCENTAGE OF REVENUE GROWTH FROM NEW PRODUCTS** This is one of the top three most widely used metrics, according to a recent BCG survey.

**WARNING!** It's easy to game. Companies measure new products differently. If you change the color of a toothbrush, is it a new product? The percentage also goes up if overall sales go down, so a particularly bad year for sales may disguise itself as a great year for innovation.

## INNOVATION RETURN ON INVESTMENT

Most companies flag this as important, and they're anxious to figure out how to develop it, but few currently employ this kind of ROI.

**WARNING!** Return on investment is a very difficult measure to construct. No one has a commonly accepted ROI metric, and many are in use.

**KILL RATE** This is the number of ideas that you decide can't work. If your kill rate is too low, you are not loading enough new ideas into the front end of your innovation process. You are also not taking enough risk.

**WARNING!** Companies kill most ideas at the front end. They should cull ideas at each stage of the process. Managers often fail to document why an idea didn't work, and the company is destined to repeat mistakes over again.

-Jessi Hempel





## The CEO of Infosys on Obstacles to Innovation in China and India

**G**lobalization and the convergence of information and communication technologies have dramatically boosted the power and speed with which businesses, organizations, and individuals can access, process, and adapt information. This has given rise to the knowledge economy, where markets can trade what has long been untradable: workers' education and skills. In the new dynamic, efficiencies in productivity growth are less important. Instead, growth is driven by the capacity of economies to create knowledge and innovate.

Three new innovation models are emerging. One is process innovation: wiring everyone to the same network and leveraging the cost, talent, and volume of an integrated global economy. Another is creating pint-sized products and services sold cheaply to masses of poor people. A third is innovating through local partnerships and networks to get around external hurdles, whether bad roads in India or bad government policy on IP in China. You see all three models in India. Boston Consulting Group put out a list of 100 emerging global companies; 21 of them were in India.

Initially, cost advantages attracted global companies to the emerging markets of China and India. China's Pearl River Delta quickly became a hub of low-cost manufacturing, and the country's manufacturing sector grew annually at 11.4% from 1993 to 2003. After economic reforms in 1991, India's large pool of low-cost, technically trained tal-

ent made possible that nation's growth as a global provider of IT services.

But today multinationals are beginning to leverage the skills of Indian and Chinese knowledge workers to innovate, and they are building strong R&D capabilities in these markets.

Innovation in China and India, however, has not grown on a truly global, commercially significant scale. Indian companies have yet to come up with significant innovations in entire product lines. Chinese outfits have launched clever but imitative products, and China's R&D capabilities lag those of Taiwan and South Korea.

China and India rank 49th and 50th in the world respectively in terms of productivity growth. Their economies face major challenges to improved innovation. They lack end-to-end logistics, effective infrastructure, and strong regulatory systems. By understanding such weaknesses, corporations can devise alternate strategies and business models to transform the two countries into growth markets.

India has poor infrastructure, low literacy levels for many people, and labor inflexibilities. So high-volume manufacturing has not taken off yet in a big way. Yet businesses are using technology and communication networks to build virtual, interconnected innovation ecosystems to overcome the gaps. A network can tap multiple sources of innovation, including entrepreneurs, research labs, and students and faculty in educational institutions, such as the Indian Institutes of Technology (IITS).

Unearthing specific consumer needs in emerging economies can also aid innovation. HP Labs in India identified power outages as a key factor limiting the access and utility of computers in rural areas, so it designed a community PC that can run on car batteries.

There's huge innovation in creating a high-volume, low-price business. CavinKare, an Indian company, began selling shampoos in the 1990s in cheap, single-serve sachets to make them accessible to the nation's rural poor. This business model was replicated by Unilever and Procter & Gamble.

India absorbs about 4 million to 5 million mobile phones a month, and its mobile rates are about 1¢ a minute, the lowest in the world. Clearly companies have innovated: They figured out how to stay profitable even selling telecom services at a penny a minute. They're reaching consumers who are essentially not part of the formal financial system. If you can deliver to such people products or services in small units at a low price, the market is suddenly open to a much larger base.

In the end, innovation capability depends on economic flexibility. The U.S. with its entrepreneurial culture, relaxed labor markets, and free capital flows, continues to be the most innovative economy in the world. India and China need such an environment to bridge the growth and productivity gap between emerging markets and the developed world and to truly transform themselves into innovative, energetic economies.

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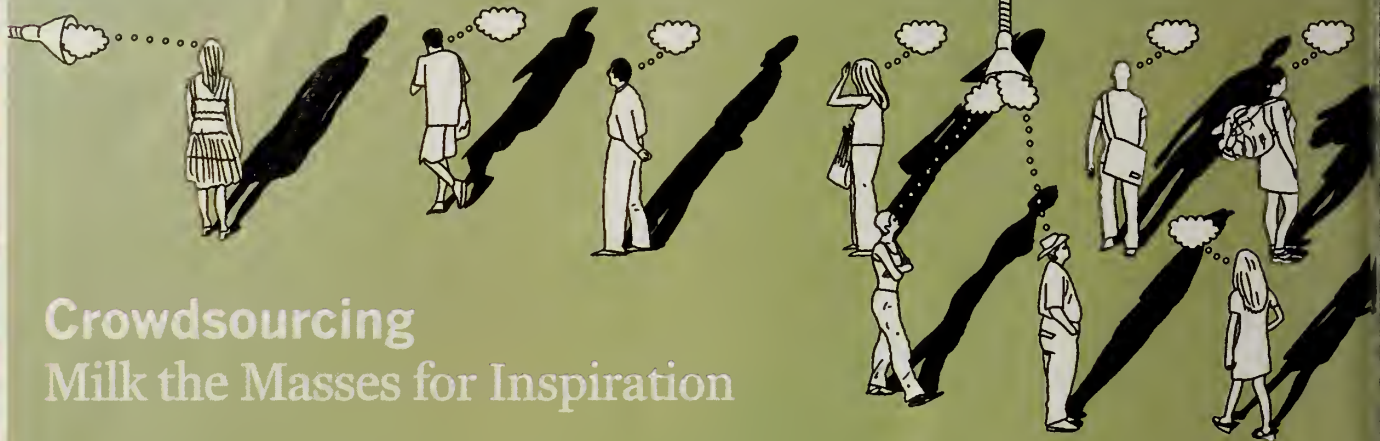
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## Crowdsourcing Milk the Masses for Inspiration

A Japanese paper fan unfolds across a television screen, mysteriously hiding the white-painted face of a woman. When it folds up, the face reappears, this time with theatrical green eye shadow. Fade to black beneath the slogan: *Find color in confidence. L'Oréal Paris*. It's a flashy, high-concept ad that resonates with the consumer. It was created by a consumer.

If produced in-house, this ad could cost L'Oréal \$164,200, the going production price for a glossy 30-second TV spot. Instead, the beauty product company turned to Current TV, the cable television station that relies on user-generated content for much of its programming. Current TV has built a social network where viewers can create and upload five-minute media segments, post comments on other viewer-made clips, and vote on which ones should be aired. This spring, Current TV opened the process to ads, posting assignments for people to work on. After making a sponsorship deal with Current TV, L'Oréal paid the ad's producer, who uses the handle "spicytuna," \$1,000 for her creative endeavors. Do the math.

Companies have been outsourcing to India and China for years. Now they are taking it to another level by using social networks such as MySpace, Second Life, and a multitude of virtual communities to solve their most gnarly business problems. Business model innovation is happening at a lightning clip. First there was outsourcing, then open-sourcing, and now crowdsourcing.

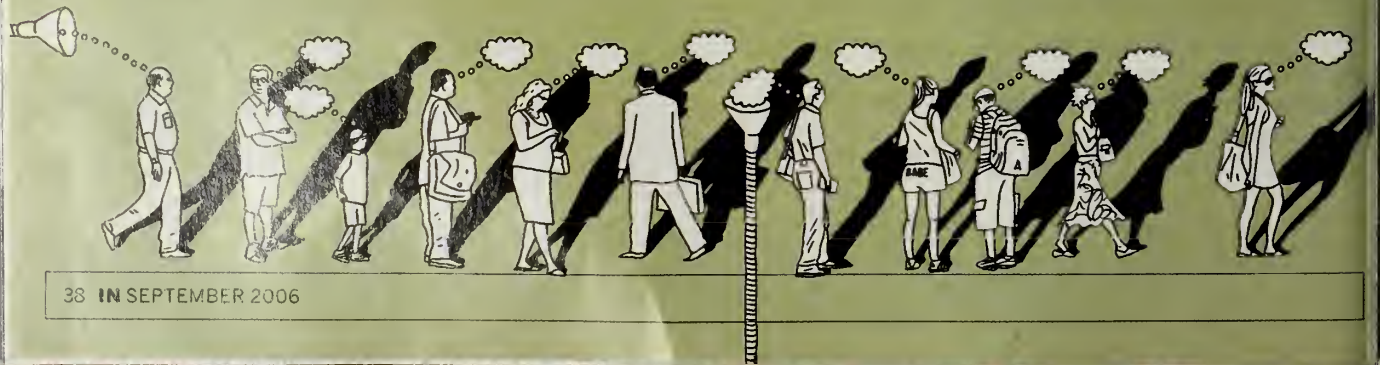
Who's into crowdsourcing? Getty Images recently paid \$50 million for iStockphoto, a Web site where more than 23,000 amateur photographers upload and distribute their

stock photographs. Hipster clothing company Threadless.com prints and sells t-shirts designed by people on its Web site. Linden Lab's 3-D virtual world, Second Life, allows people to create and retain the intellectual property rights on new businesses, brands, and personalities. John Fluevog Boots & Shoes' Open Source Footwear site invites fans to submit and vote on new shoe designs. Ducati Motor Holding builds fanatical brand loyalty and brings customer insights into designing new motorcycles through Ducati.com.

But in their rush to capitalize on the wisdom of the masses, many companies are making big mistakes. Kraft was lambasted on the Web for not really "getting" web collaboration when it simply posted a digital suggestion box on its Web site. Though Kraft said critics misunderstood their effort, which was part of a larger strategy of open innovation, the danger remains that companies will rush to set up consumer communities without carefully considering what they're after and how they plan to use it. It is very easy for crowds to generate the lowest common denominator among solutions.

Smart crowdsourcing is about how we winnow the wisdom from the wash, and what we choose to do with it. Here are some key guidelines to follow:

**1. BE FOCUSED** Vaguely defined problems get vague answers. Current TV is explicit about the goal of its viewer-created ad messages (v-cam's): to develop new advertising to run online and on the cable network. And it allows companies such as L'Oréal or Sony to mine the v-cams for fresh advertising ideas.





The more infrastructure you build into the creative process, the more success you will have. Current TV has clear rails to support social networkers. It provides a specific focus such as the one for Sony Ericsson's Walkman Phone: "With a Sony Ericsson Walkman®Phone you're always connected to your music. The question is: where will it take you?" It also provides a Sony Ericsson logo and a smattering of graphics, as well as instructions that include a time limit—up to three minutes—and a deadline—September 8. Current TV also spells out directly in its rules that the network retains the power to reject anything that paints the brand in a negative light.

**GET YOUR FILTERS RIGHT** Crowdsourcing often produces a wealth of ideas, and companies need effective filters to pick the gems. Consider IBM's innovation jam, a two-part brainstorming session launched in July designed to tap the collective minds of employees, family members, and customers to target potential areas for innovation. CEO Sam Palmisano will put \$100 million into promising ideas.

IBM identified four large themes, providing interactive background information on each one, employing moderators to keep conversations focused, and setting a 72-hour time limit for the first session. By the end of it, IBM had collected 7,000 ideas. IBM will use its own crowd to filter the ideas. The company has made transcripts available to the 140,000 people who logged in to the first session and teams will review the posts. In early September, the company will host a second session, where everyone will again log on to the jam session to vote on the ideas with the most potential. Then senior executives will sift through this short list to make recommendations about which should be funded. Palmisano will have a hand in making the final choices.

**TAP THE RIGHT CROWDS** At YouTube and probably within any new social network, only 1% of the users are active content creators. Another 10% interact with the content and change it. The remaining 89% passively observe. Smart companies want to assemble the crowds with the most sophisticated knowledge about their business problems to maximize the impact of the small percentage of idea generators within them. Consider InnoCentive, a social network created by Eli Lilly where companies like Procter & Gamble and Boeing can pay a steep fee to post the knotty problems they can't solve internally—like the process for the extraction of trace metal impurities, for example. The idea is that individual problem solvers—retired scientists, obsessive hobbyists, university students—might be able to lend a hand. If they solve the problem, they receive a hefty cash reward.



This network is dependent on a crowd of extremely talented scientists with highly specific skills. To attract them, InnoCentive recruits at universities, where young, smart minds have not yet entered the workforce. To date, the network has signed agreements with 25 Chinese universities, including the prestigious Chinese Academy of Sciences and the National Natural Science Foundation of China. The network also promotes itself at industry events and advertises in trade publications.

Also key, Innocentive's rewards for solutions are sizable. Crowdsourcing is not cheap. Just as in corporate America, top talent is expensive, and companies will have the most luck when they are willing to pay up for the inventions that lead to potential innovations.

**4. BUILD COMMUNITY INTO SOCIAL NETWORKS** Cash is key to getting people to participate, but successful crowdsourcing taps into a well of passion about a product that stretches beyond monetary incentives. Cambrian House, a software company founded by Michael Skorsy, relies entirely on crowdsourcing. Everyone who contributes an idea receives royalty points, which function as equity in the final product and can eventually be cashed in for stock. But Skorsy has also created glory points, which reward members who collaborate. He says one key element in keeping people engaged long-term is for them to build friendships with other members. It's not so different from the eBay model, where buyers and sellers rate each other and offer commentary. These interactions foster trust and keep people active in the community.

Crowdsourcing is a new and nascent business tool for innovation. Used properly, it can generate new ideas, shorten research and development time, cut development costs, and create a direct, emotional connection with customers. Used improperly, it can produce silly or wasteful results. Crowds can be wise, but they can also be stupid.

—Jessi Hempel





## COLLECTING THE WISDOM OF CROWDS

The open source movement introduced a new way to develop software by collecting input from dedicated hobbyists. Crowdsourcing ups the ante by putting a business problem in the hands of virtual crowds and compensating those with the best ideas.

—Aili McConnon

### Most popular industries

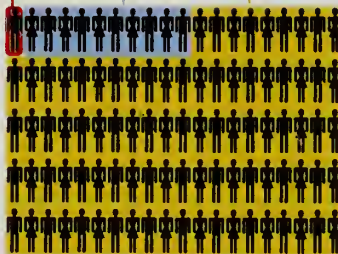
among citizen content creators

- 1 electronics
- 2 fashion
- 3 media
- 4 computers
- 5 sports/outdoors

### The 1% rule for user-generated content

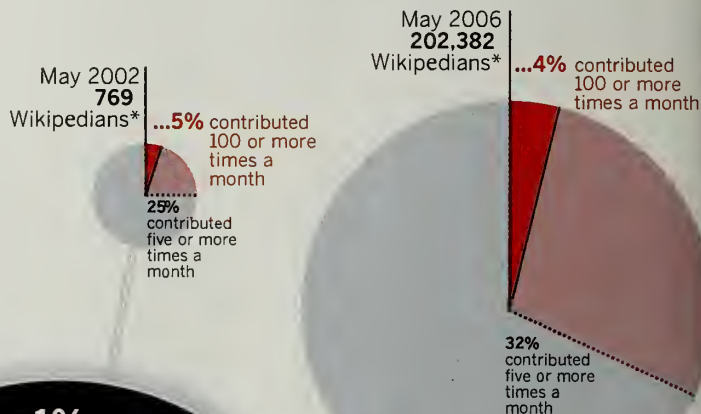
In a group of 100 wired people...

- ...one will create content
- ...10 will interact online
- ...89 will view the content and interactions



### Contributions to Wikipedia

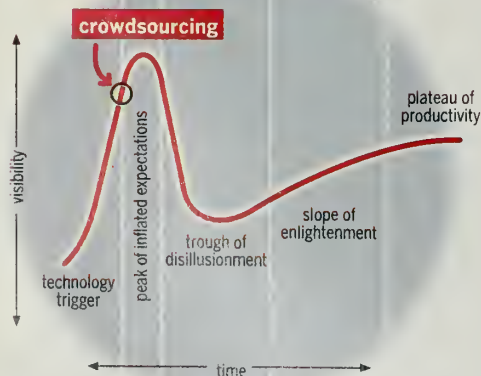
The online encyclopedia written collaboratively by contributors around the world in 230 languages.



\*A Wikipedian is someone who has contributed 10 times since signing on.

### The hype curve

Inside Innovation applied Gartner's hype curve, which shows a typical lifespan of a new trend or technology, to crowdsourcing.

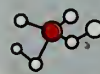


### How large are crowdsourced crowds?

**www.seconlife.com (Linden Lab)**  
650,000 people have signed up. 85% modify content; 66% generate it.



**www.innocentive.com**  
100,000 scientists have solved challenges posted on the site.



**www.globalinnovationjam (IBM)**  
57,000 people participated in the first Innovator Jam. They produced 37,000 ideas.



**www.fluevog.com (Fluevog shoes)**  
20,000 people have visited the site; 500 submitted designs.

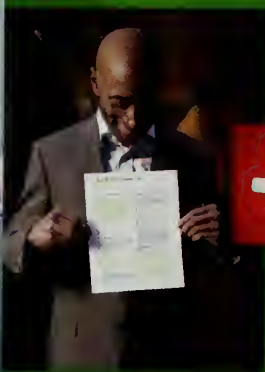


**www.cambrianhouse.com**  
5,500 members have signed up. Of those, 117 have contributed to products.



Data sources: Bradley Horowitz; Yahoo! ProductWiki stats.wikimedia.org Gartner Companies

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# Betting the Ranch on Casinos

Can U.S. gamblers' appetites keep up with the current wave of expansion sweeping the industry?

JANE SASSEEN

IS THERE A LIMIT TO AMERICANS' hunger for gambling? Casino executives are putting their money squarely on "No." With expansion plans on the table from Biloxi to Las Vegas, \$25 billion to \$30 billion could be poured into new casinos and the surrounding shops, hotels, and condominiums by the end of the decade.

Behind the boom: strong revenue gains and a wave of mergers, which have players like MGM Mirage and Harrah's Entertainment sprucing up older properties and building new ones. Fresh markets are opening, up, too: Pennsylvania could soon award 14 casino licenses, while Atlantic City and Biloxi, Miss., are adding fancier railers, glitzier entertainment, and trendy restaurants in a bid to become Vegas-like destinations in their own rights. And that's not even counting the \$2 billion Indian gaming industry, which has more than doubled since 2000.

But will demand increase fast enough to keep all those hotels, restaurants, and slot machines humming? Vegas is showing signs of strain. Even though gambling revenues in 2005 jumped 11.5%, to \$7.6 billion, growth is slowing, and the key hotel business is stalling. Shares of MGM Mirage are down 23% since May, while No. 1 Harrah's Entertainment has fallen 25%.

Casinos say the industry is steadier and more recession-proof than most. "Compared with housing or other areas that are now slowing, gaming remains an attractive place to put capital," says James J. Duran, president and chief financial officer of industry No. 2 MGM Mirage.

They're backing up the talk with huge investments. MGM is planning a \$7 billion CityCenter complex in Las Vegas that will include 6,800 hotel rooms and condominiums, along with a casino and loads of railers, spas, and other goodies. Las Vegas Sands Corp. and Wynn Resorts will each drop \$1.6 billion on top-of-the-line resorts. All together, \$20 billion could be invested in Vegas in coming years, says







**BILOXI BOOM?** A surge since Katrina could make it an upscale tourist resort to rival Orlando

compete with Las Vegas and Orlando. Before the storm, Biloxi was a mature market; revenue growth at the casinos, limited by riverboats and barge chugged along at slightly more than inflation. But post-Katrina law changes allowed casinos to move onto dry land. And the destruction of buildings created big tracts for new casinos.

All that has set off a boom. When two local construction magnates, Robert Anderson III and William "Cotton" Fore, bought the run-down President Casino

Standard & Poor's, boosting the supply of hotel rooms alone by 30%.

Other cities are applying the Vegas model. Atlantic City had long been little more than a run-down market for day-tripping slots players, with few of the goodies that have made Vegas a mecca even for nongamblers. But the surprising success of the Vegas-style Borgata Hotel Casino & Spa, opened in 2003, has encouraged operators to spend billions for more pizzazz. MGM is designing a smaller version of its CityCenter, and Harrah's and Trump Taj Mahal Hotel & Casino are investing in shops, hotel towers, and expanded casinos. Several all-new projects are also in the works. Says David Berman of Credit Suisse: "The Borgata proved that if you put a compelling site there, people will come."

But investors are worried that slowing consumer spending will hit hard. Steven Kent of Goldman Sachs & Co. points out that growth in revenues per room at casino hotels fell during the second quarter. If casinos are forced to spend more on splashy marketing to get customers in the door, things will get worse. And then there's the prospect of overbuilding. "Could they be stuck with a glut? That's the risk," says Joseph Fath

of T. Rowe Price Associates. "If the economy is weak, they could all suck wind."

Perhaps nowhere are those questions more in play than in Biloxi. Hurricane Katrina destroyed 2 of Biloxi's 10 casinos and damaged others. So far, the sector has proved resilient: In the first six months of 2006, with just three casinos reopened, gamblers bet \$375 million—nearly 60% of what they had spent the year before.

Operators have ambitious plans to transform Biloxi into an upscale resort to

Broadwater Resort at a bankruptcy auction in early 2005 for \$82 million, rival scoffed that they had overpaid. Now, bankers say the land is worth twice that. The pair have been approached by four casinos to join in their expansion plans for the site.

## OFF THE BARGE

AT THE NEARBY Harrah's Grand Biloxi, which reopened in mid-August, rebuilding was just the first stage. The company also bought the site next door and will spend up to \$1 billion on an elaborate new resort. "There's a lot more you can do to build an appealing facility when you're not forced to do it on a barge over water," says Anthony Sanfilippo, president of the central division of Harrah's Entertainment Inc. That will put Harrah's more directly in competition with MGM Mirage's Beau Rivage Hotel & Casino, Biloxi's most luxurious property before the storm. MGM spent \$500 million on an upgrade of the place, which reopened on Aug. 29, that includes renovated rooms, high-end restaurants, and additional casino space.

Both will have to fend off new players. Indian-owned Foxwoods Resort Casino, which runs North America's largest site in Connecticut, entered talks in March with Fore and Anderson to invest \$400 million to add a second casino and resort on the Broadwater site. Landry's Restaurants recently bought a beachfront site where it wants to build a Golden Nugget, while Trump Entertainment Resorts announced a joint venture with an operator in nearby Diamondhead, Miss.

All together, developers say \$3 billion

## Where the Bets Are

Top 10 non-Indian gambling markets

|                             | 2005 GAMING REVENUES (BILLIONS) | YEAR-OVER-YEAR GROWTH |
|-----------------------------|---------------------------------|-----------------------|
| Las Vegas                   | \$7.6                           | 11.5%                 |
| Atlantic City               | 5.0                             | 4.4                   |
| Indiana                     | 2.4                             | 4.1                   |
| Louisiana*                  | 2.2                             | 5.8                   |
| Illinois                    | 1.8                             | 4.7                   |
| Mississippi—river counties  | 1.6                             | 2.1                   |
| Missouri                    | 1.5                             | 4.1                   |
| Mississippi Gulf Coast**    | 1.2                             | 1.0                   |
| Detroit                     | 1.2                             | 3.3                   |
| Iowa*                       | 1.1                             | 4.3                   |
| All U.S. commercial casinos | 30.3                            | 4.7                   |

\* Reflects fiscal year ended June 30, 2005

\*\* Reflects 12 months prior to Katrina

Data: Standard & Poor's, American Gaming Assn., Mississippi Gaming Commission, Missouri Gaming Assn.



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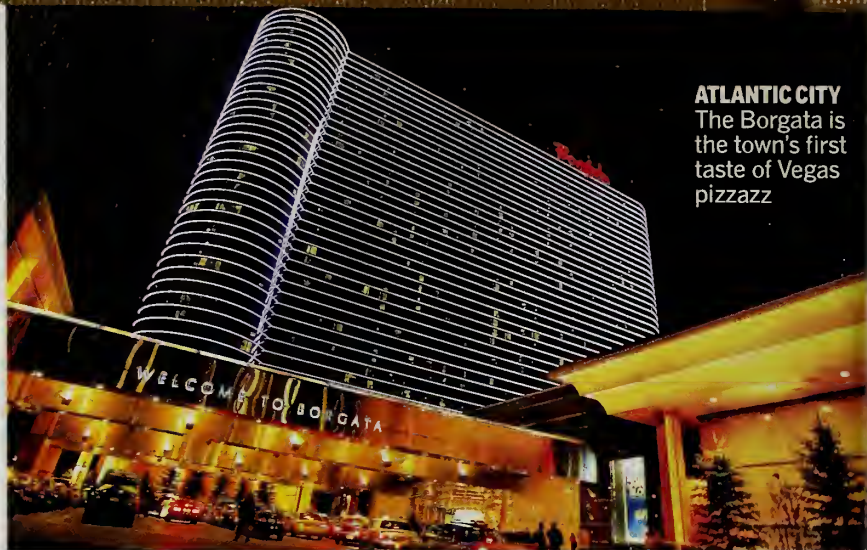
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\$5 billion could flow into new projects over the next few years. Biloxi Mayor A.J. Holloway predicts the number of casinos could double, to 20. A huge bump up in hotels and condos is coming, too: From around 17,000 rooms today, local officials aim to hit 30,000 by 2010.

The question is whether the buildup will be more than Biloxi—and the rest of the industry—can handle. The Gulf Coast has historically drawn a regional crowd; gambling revenues for Biloxi plus three other Coast casinos for the 12 months before Katrina were \$1.2 billion. To boost that number, Biloxi will have to bite off a bigger share of the national market. That's no sure thing; there's some image-polishing to be done before people will hop on a plane to Biloxi for a leisure junket.

Investors are starting to worry. Matt Sodl, managing director of Innovation Capital, an investment bank that specializes in gambling, says some clients look-



**ATLANTIC CITY**  
The Borgata is the town's first taste of Vegas pizzazz

ing at deals aren't sure the market's size will earn sufficient returns. Rising costs are a concern as well: Along with land prices, building costs and insurance rates have spiked dramatically. "People are starting to scratch their heads," says Sodl. "They're not sure they can make the numbers work."

But executives in Biloxi and elsewhere are quick to point out that the same has often been said about Las Vegas even as the market has continued to grow. Gambling, they say, is a market where extravagant new resorts can create their own demand. With all the construction coming down the pike, that had better remain true. ■

## FLASH POINTS

# A Vote on Gaming Sends the Mud Flying

BY JANE SASSEEN

**F**rom Biloxi to Detroit, tax-starved communities across the country have long welcomed casinos. Not so Long Beach, Miss., a town of 17,000 just 16 miles from Biloxi.

Twice before, residents voted down proposals to allow beachfront gambling.

But in the wake of Hurricane Katrina, which devastated Long Beach, the debate over casinos has erupted anew. When gambling proponents this spring proposed another vote to allow casinos into a choice spot near the harbor, it set off an emotional battle. And after the news broke that a former town alderman had not only optioned the land on which a casino could be built but had also funded the ad campaign backing the casino, the fight over the town's future got downright nasty. As town meetings swirled with thinly veiled allegations of corruption and nearly ended in fistfights, one thing was clear: Even

as gaming has become accepted in much of the country, it remains a flash point.

Casino advocates say the town desperately needs the revenues that gaming would bring. "Aug. 29 changed everything," says Allen D. Holder Jr., the alderman who proposed the new vote.

But opponents argue that the city's financial woes were being exaggerated and

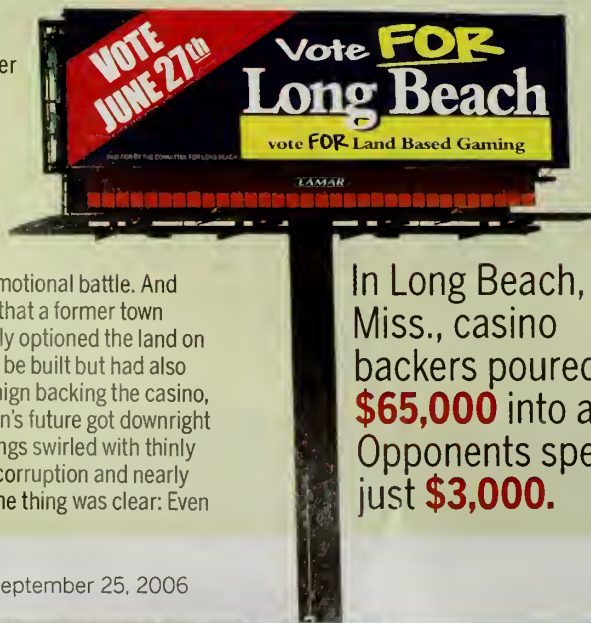
that new stores and condos could just as easily refill the coffers. "Why would you want to put a big casino in a little town like this?" asks Terri Long, whose home near the shore was flattened by Katrina. "It will completely change the character of the area." Still, when the Chamber of Commerce offered to pick up the tab for a referendum for the broke town, even casino opponents went along with the idea of letting citizens vote once more.

In the weeks before the June 27 election, townspeople discovered that Jimmy Levens, a former alderman who runs a construction company, had bought an option to purchase the land on which a casino would go. The news came a day after *The Sun Herald*, the local paper, revealed that a company owned by his daughters had reimbursed the chamber the \$15,000 cost of the referendum. Soon, voters learned that a group that had blanketed the city with pro-casino signs, letters, and a TV ad campaign had also been funded with \$65,000 from Levens.

Meanwhile, an anti-casino group led by a Baptist preacher had just \$3,000 to spend.

Opponents tried to call off the vote but failed, and by 54.7% to 45.3%, Long Beach backed gaming. Richard Burton, an alderman, calls the outcome a travesty. "This is just the worst kind of nepotism and self-interested politics," he says.

Levens and Holder say that's little more than sour grapes. "I didn't walk up to the ballot box with anyone to vote," Levens says. The important thing, he says, is that the people got a chance to vote, and now it's up to the city to decide what comes next.



In Long Beach, Miss., casino backers poured **\$65,000** into ads. Opponents spent just **\$3,000**.



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# What Are All These Shorts Doing Here?

Jarden's acquisition strategy has sent its stock soaring, but plenty of bears are betting against it

BY JUSTIN HIBBARD

**C**HANCES ARE YOU'VE never heard of Jarden Corp. But you've probably owned at least one of its products. Among them are the CrockPot cooker, the Mr. Coffee coffeemaker, and Coleman camping gear. The Rye (N.Y.) company has been a cult favorite of growth stock aficionados over the past five years. A \$10,000 investment in Jarden's predecessor, Alltrista Corp., in 2001 would be worth \$109,962 today, making Jarden the 10th-fastest-growing stock over the past five years among U.S. companies valued above \$1 billion.

But among Jarden's most ardent followers is a sizable faction that roots for its stock to go in the opposite direction. In the past year, while its shares rose to a record 42, an average 15.3% of the company's float, or the shares that trade freely, was sold short each month. Only 5% of public U.S. companies valued above \$1 billion have percentages that high. Investors who got in and out of short positions in Jarden from early May to late June profited as the stock sank from 35 to 28 (it's now around 31). Among those taking a keen interest recently: über-short James Chanos, managing director at New York hedge fund Kynikos Associates Ltd., say people familiar with his research. (Chanos declined to comment.)

## FIFTH ANNIVERSARY

SHORTING JARDEN IS not for the faint of heart. Its management has succeeded three times before with similar ventures. Martin Franklin, Jarden's 41-year-old chief executive officer, and Ian Ashken, its 45-year-old chief financial officer, have a strong record of boosting companies' market values through serial acquisitions. That's what they're doing at Jarden: acquiring a diverse portfolio of consumer



products companies including the former Sunbeam Products Inc. and Holmes Group Inc. Two previous consolidations, Benson Eyecare Corp. and Lumen Technologies Inc., rose 1,569% and 107% in value, respectively, under the duo's guidance.

But the team sold both those companies within four years of taking charge. September marks their five-year anniversary at Jarden. Having taken the stock from 2.50 to 42, how much more value can they squeeze out? Says Franklin: "Are there still hundreds of millions if not bil-

**FRANKLIN** He took the stock from 2.50 to 42

lions of dollars of value to be created? Absolutely. If I didn't think so, I'd be gone.

The bears' litany of knocks against Jarden are mostly financial. Jarden has accumulated a \$1.5 billion debt load to finance acquisitions, giving it a 154% debt-to-equity ratio (the industry average is 128%). Franklin counters that the ratio lenders care most about is debt to earnings before interest, taxes, depreciation, and amortization, and that ratio is 3.3, the industry average. Bears fault Jarden for emphasizing adjusted EBITDA in its press releases and analyst calls instead of free cash flow, which has been negative for the past two quarters. Franklin says Jarden's highly seasonal cash flows are weighed down in the year's first half by rising inventories and accounts receivable, which get corrected in the busy third and fourth quarters.

## JANUARY DIVE

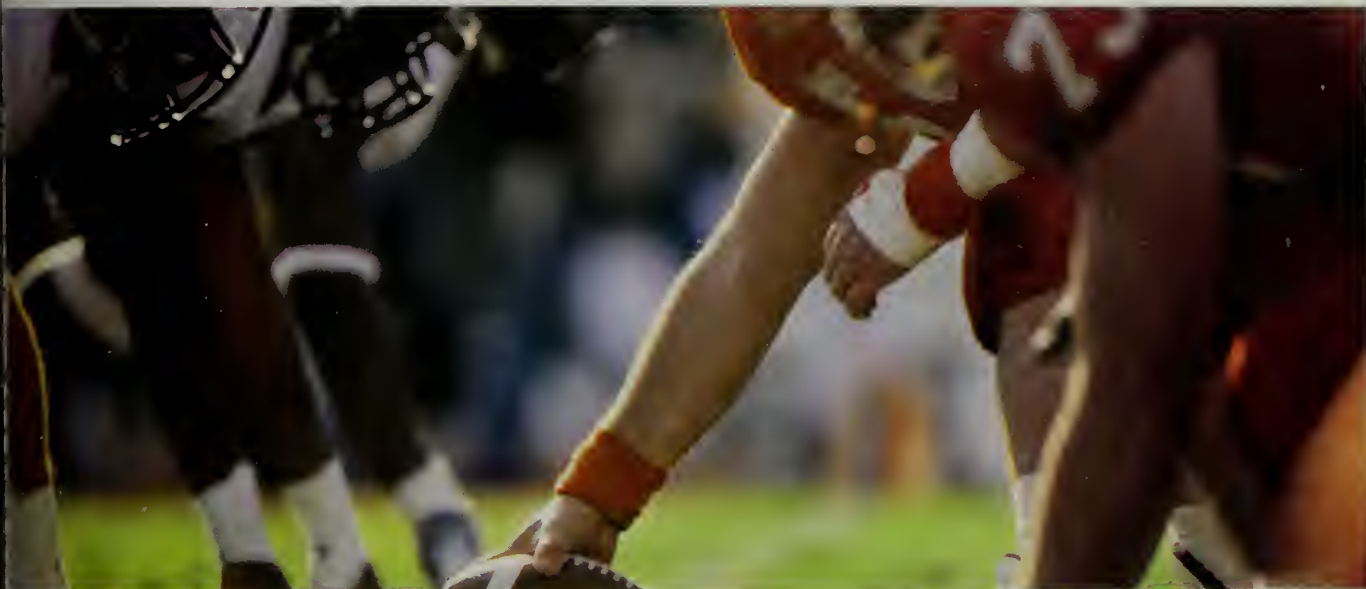
BUT THIS YEAR'S second half may not play out as in years past. Retailers, anxious to boost flagging earnings, are streamlining inventory and not buying as many brands. Spectrum Brands Inc., maker of Rayovac batteries and Cutter insect repellent, has fallen 63% since April largely because of such cutbacks. "Jarden may face the same get or Wal-Mart saying: 'We're not going to take this product this year,'" says Amit Chokshi, managing member at Stamford (Conn.) hedge fund Kynikos Capital Management. (Chokshi declined comment on whether he's shorting Jarden.) Franklin says Jarden should be safe because most of its products are category leaders.

Franklin is all too aware of what he calls "the cynics." In January, when Jarden missed fourth-quarter earnings per share estimates by a dime, 4.5%, the stock shed 17% of value in a week, and class action lawsuits flew fast and furious. "It's probably the biggest motivator of me not wanting to run a public company anymore," he says.

How's that? Franklin says he's committed to Jarden for the long haul and \$65.6 million worth of stock to motivate him. But "nirvana for me is to run 100% my own business." That raises an intriguing prospect: The stock likely won't go far from here, but a leveraged buyout could fetch a premium. If that happens, shorts will have made a costly mistake.

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# Nightmare Mortgages

Our cover story on option ARMs struck a nerve with brokers, bankers, and consumers

MARA DER HOVANESIAN

**H**ousing stories tend to fire people up these days, but we were surprised by the response to our Sept. 11 cover story, "How Toxic is Your Mortgage?" The article centered on option ARMs, extremely risky and complicated loans that have gained popularity in recent years. It cast a critical eye on the mysterious inner workings of the mortgage industry—and in turn stirred the passions of bankers, mortgage brokers, accountants, investors, and consumers alike. Comments started pouring in as soon as we posted the article on our site on Aug. 31. Option ARMs were created a quarter-century ago to appeal to

wealthy borrowers. But as the recent housing boom wore on, bankers and brokers began marketing the risky loans as affordability tools for the masses. The lenders profited nicely, as did the hedge funds that bought the loans. But borrowers, we argued, will suffer disproportionately when those loans blow up.

Many readers expressed outrage that banks are able to book the full amount of an option ARM payment as revenue even when they receive much less than that amount. Some readers were offended by what they deemed our broad-brush characterization of mortgage brokers. And others said we didn't heap enough responsibility on borrowers, who should have known better.

Here's a sampling of the feedback we got.

But these [mortgage] products are deceptive and should not be offered to the general public.

> David Coker, London

down" the disadvantages. But to present the entire industry as toxic is going a little too far.

> Oren Orkin, Chicago

It is not clear to me how long regulators can stand on the sidelines and do nothing about option ARM lending. Clearly, the long-term effects are detrimental to consumers, communities, banks, and investors alike. Why wait for yet another S&L crisis to cost taxpayers big bucks?

> Michael R. Adamian, Elburn, Ill.

Yes, there are bad apples in the industry, and they need to be called to account. But to paint us all as money-hungry predators looking to pad our wallets at the expense of the home-buying public is like equating all journalists to [discredited former *New York Times* reporter] Jayson Blair.

> David "Skip" Dyer, ProActive Mortgage, Cary, North Carolina

There's no such thing as a free ride. Whether it's tech stocks, ARMs, or oil, the market eventually squeezes out the excess. The only thing that changes is the color of the package.

> screen name: Barinr (BusinessWeek.com)

As a mortgage broker, I was appalled by your article. True, we are "commission hungry," as that is our only source of income, like so many other employees of the real estate industry. And yes, we do try and "make the sale," like all other salespeople who are commission-based, and sometimes highlight the benefits of certain products and "play

I am a mortgage broker, and I absolutely hate the option ARM. It was meant to be a niche product, and it is a shame that it has become so popular. Greedy brokers who care only about commissions are the ones pushing them on people. Many loan officers don't even fully understand the option ARM loans they are pushing, or the risks.

> Scott Lafferty, Saratoga Springs, Utah

I hate to say it, but most of the people mentioned in this article are fools. You "didn't expect" the 1% rate to go up? Well, then, you

The option ARM might be the riskiest... home loan product ever created. The low payments are only temporary. And the less a borrower chooses to pay now, the more is tacked onto the balance."

—from "How Toxic is Your Mortgage?"

a banker, and I consider [option ARM] irresponsible lending. People should be red toward long-term, fixed-rate debt, and they can't afford it they should stay out of the market. I'm in investment banking/capital markets and don't feel a twinge of guilt if I go around someone and take their money.



are a moron. Option ARMs didn't show up overnight. They have been around for years, suckering people into buying things they can't afford. If you can't afford a traditional 30-year mortgage, buy a cheaper house.

> Bryan R. Beal, University Heights, Ohio

The problem I see here is everyone's fault—the lenders for pushing these loans down people's throats and home buyers who got caught up in the frenzy.

> screen name: Modog (BusinessWeek.com)

To blame the borrower for getting screwed is preposterous. Naive, perhaps, in the belief that the lender has their best interests at heart. But as I tell many I counsel, if it sounds too good to be true, it is.

> screen name: Counselor (BusinessWeek.com)

Give me a break! The option ARM is a great wealth management tool—if you have a significant amount of future income coming, like a large bonus or commission, and can pay down a large amount of principal with that future income. Once you pay down the principal, the payment amounts are recalculated lower. Using the bank's money to buy time at a 1% rate for a soon-to-arrive cash infusion is a great wealth-building strategy if smartly utilized.

> Bruce Hiatt, Realtor, Las Vegas

**"Banks can count as revenue the highest amount of an option ARM payment even when borrowers make only the minimum payment. In other words, they can claim future revenue now, inflating earnings per share."**

—from "How Toxic is Your Mortgage?"

I would be interested in some explanation as to how the Financial Accounting Standards Board could intellectually justify accrual accounting standards with option ARMs, given the attendant risks.

> Michael Horwitz, Austin, Tex.

How do [banks] plan to cash in on this phantom money, owed by people who can't afford to pay? Are they just going to pass on the hot potato until the last person left holding it gets burned fingers?

> Julian Morrison, Reading, England

As a CPA, I am offended by the presumption that there is a problem with the accounting for deferred interest. The author implies that the accounting industry is to blame for money not yet paid being recognized as income by the banks. This happens in every industry, except that in other industries it is not called deferred interest, but rather accounts receivable. Does the author mean to say that all accounts receivable transactions are phantom profits? As for who to blame for the problem: the banks, for extending the credit, and the homeowners, for not understanding the contracts they signed.

> Michael Rhyce, New Fairfield, Conn.

The intent in all cases is to show profits on the books that do not exist. This is a conscious and willful attempt to mislead investors as to the profitability of their operations.

> John Hunter, Winter Park, Fla.

This is one of the most massive scams I have seen. I truly fear the consequences.

> Chuen Ng, Lancaster, Calif.

Why weren't you writing articles like this in 2002, 2003, 2004, when it was obvious to people who understood what was going on (meaning your reporters) that this was a ticking time

bomb? The media had a large role in remaining silent about an obvious problem and shaping the housing mania.

> David Dalka, Chicago

**"After prolonging the boom, these exotic mortgages could worsen the bust. They betray such a lack of due diligence on the part of lenders and borrowers that it raises questions of what other problems may be lurking."**

—from "How Toxic is Your Mortgage?"

I am one of those homeowners who could not resist the urge to buy a home two years ago. My ARM loan will expire in October, and the lender has already informed me of the interest and payment increase coming in November. I guess I could refinance, but will I qualify for a conventional loan? It's definitely a rude awakening.

> screen name: ARMn (BusinessWeek.com)

This era of financing is [reminiscent] of the early 1980s. History will repeat itself with defaults, foreclosures,

bankruptcies. Only this time around, the '80s will look like cakewalk. I predict will begin in the second quarter 2007 and last well into early 2009.

Fasten your seat belt. I've never seen a soft landing in 30 years of being this business.

> screen name: M (BusinessWeek.com)



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# The Eyes of Taxes Are Upon You

IRS deadbeats beware. A law firm of Austin-based "bounty hunters" is on your trail

BY HOWARD GLECKMAN

**W**HAT DO YOU GET when you cross a tax collector and a lawyer? At the law firm of Linebarger Goggan Blair & Sampson, you could get rich.

Once, public employees collected most taxes. But as states and localities have sought to trim costs, they've outsourced that work. Linebarger has been there to capitalize, tracking down bad debts for government agencies at all levels, mostly in Texas. The 113-lawyer Austin firm owes some of its success to skillfully deployed political largesse. Over the past four years, Linebarger has contributed roughly \$1 million to Texas statewide candidates.

Now the firm, which handles only collections, has landed what could become its most important client. This month it began collecting debts for the U.S. Internal Revenue Service. Following its playbook, Linebarger had spent generously to lobby

Congress to direct the IRS to hire outside bill collectors. It brings a hardball reputation to its new role. "I call them bounty hunters," says Bill Aleshire, former head of the Travis County (Tex.) governing council and a longtime critic of the firm.

Dale Linebarger started collecting bad debts right after law school. "I was a 29-year-old lawyer who needed a job," he says. "Bill-collecting was not what I

thought I was going to be doing. Linebarger, now 63, started his own firm in 1976. The new chair of the firm's management committee, DeMetris A. Sampson, says governments need help gathering revenue to pay for public services. From the firm's perspective, she adds, "we expect it to be extremely profitable."

## BRIBERY CHARGES

IT HAS BEEN. Linebarger declines to disclose its revenues, but it often pockets 15% to 20% of the bad debts it collects. The firm estimates it will track down more than \$1 billion this year in back taxes and other debts. That could translate into \$150 million to \$200 million for the firm, an estimate Sampson doesn't dispute. In addition to its 66 partners and associates, it employs about 1,500 nonlawyers around the country.

Success has come with some blemishes. In 2004, Juan Peña, then a nonpartner, pleaded guilty to federal bribery charges for his role in winning collection contracts in San Antonio. Also that year, the firm confidentially settled a suit by a competitor that alleged fraud in obtaining municipal business in Texas. A spokesman says "the matter was settled to the mutual satisfaction of both parties." The IRS has acknowledged knowing about these and other controversies before awarding Linebarger the work.

At first, the IRS deal will be small potatoes. This year only about 12,000 taxpayers will be contacted by one of three private outfits: Linebarger and traditional collectors CBE Group in Waterloo, Iowa, and Pioneer Credit Recovery (a subsidiary of Sallie Mae) in Arcade, N.Y. Each will receive up to 24% of what they bring in. By 2008, the IRS plans to hire as many as seven more companies. Within a decade it expects private agencies to collect more than \$1.4 billion from 2 million recalcitrant taxpayers.

Senate Democrats are still trying to

the plan; they think the government could do the work better. Colleen Kelley, president of the National Taxpayers' Employment Union, opposes the plan, too: "From a business perspective, this is just wrong. This work can be done at less cost. The IRS employs 10,000 people. That's an argument even IRS Com-

## Private Collections

Some ways the Linebarger law firm has become a powerhouse tax debt collector:

**DOLING OUT CAMPAIGN** contributions to politicians who help it win contracts

**HIRING FORMER** government officials to lobby their ex-colleagues

**EXPANDING THE BUSINESS** and cementing local ties by merging with other well-connected firms

**BOOSTING PROFITS** by seeking to collect legal fees and penalties from delinquent taxpayers





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sioner Mark W. Everson concedes is correct.

Yet Congress approved the plan in 2004, in part because it fits with the GOP belief that turning over more government responsibilities to the private sector boosts efficiency. Lawmakers also preferred to pay private outfits a percentage of what they collect rather than directly spend to hire more IRS staff.

Even if the outsourcing plan goes forward, Linebarger partner Michael T. Val-landingham says the firm will be lucky to break even at first because startup costs are high and cases are few. But, he adds,

"the IRS is arguably the largest creditor in the world. The upside is a \$300 billion tax gap." That's the difference between what the IRS says taxpayers owe and what it collects annually, and it represents a huge growth opportunity for the firm.

Linebarger and other debt collectors used their political muscle to build support for outsourcing. Linebarger paid Washington law firm Akin Gump Strauss Hauer & Feld nearly \$500,000 from 2002 to 2005 to lobby for the law. "That's not unusual when you have an issue in Washington," Sampson says.

Spreading around money is nothing new for Linebarger. No fewer than 34 lobbyists represent it in Texas alone. And when it comes to campaign contributions, "they are very big players," says Craig McDonald, executive director of Texans for Public Justice, a campaign finance watchdog. The firm and its employees gave more than \$537,000 to candidates for statewide offices in the 2004 election cycle and have already contributed more than \$472,000 this season.

Firm founder Linebarger, who stepped down on Sept. 1 to senior adviser status, says the campaign money "opens the door so we can have an audience. We are competitive in everything we do, and that includes making contributions."

Over the years the practice has employed a former Texas governor, an ex-congressman, several ex-state legislators, and local officials. It also builds local connections by acquiring established debt-collection firms around the country. For Dale Linebarger, it's just good business: "We try to hire talented people who can open a door and help you get a contract. That's why you spend your money." ■



**CANDIDATE** DeVos is going after the Suburban driver's vote

## Shop at Target? You're a Swing Voter

Political campaigns are using consumer preferences to predict voting patterns

**BY RICHARD S. DUNHAM**

**I**F YOU DRIVE A CHEVROLET Suburban, Dick DeVos wants to sell you something. But the longtime Amway Corp. executive isn't hawking tires or sound systems. He's selling himself.

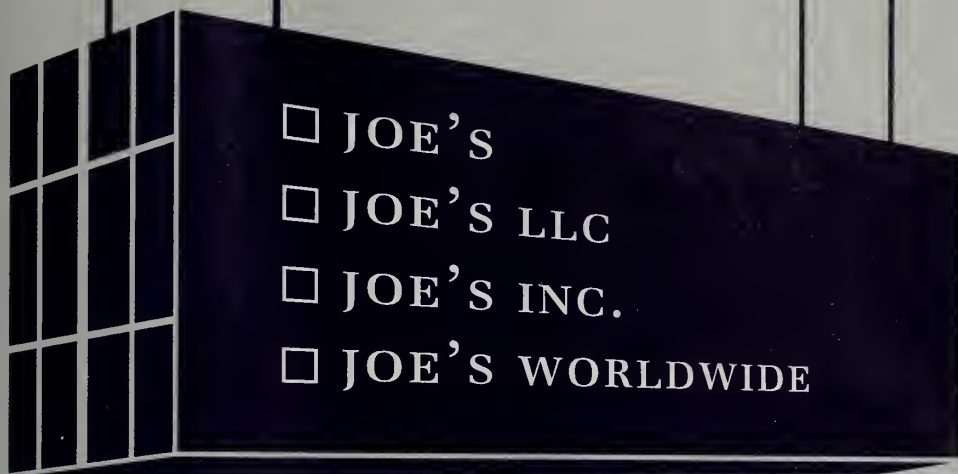
DeVos is a conservative Republican running for governor in Michigan, and he figures that if you're the typical Chevy Suburban driver—a middle-income parent who lives outside the city—you might just be his kind of voter. DeVos is using some of the same marketing and persuasion techniques used for decades by American businesses in an attempt to locate potential customers for his political campaign.

In the new world of "corporate affinity"

politics, more and more campaigns working with commercial data-mining firms to build databases of voters' consumer preferences, hobbies, and media viewing habits. When cross-indexed against publicly available voter information, campaigns can target, with astonishing reliability, both potential supporters and key swing-voter blocs. Candidates then reach out to the voters they have identified via personal contacts, phone calls, direct mail, e-mail, or Internet ads that pop up when the voter visits certain Web sites.

This fall, DeVos, California Governor Arnold Schwarzenegger, and about a dozen other statewide candidates hope to benefit from the lessons learned by American companies.

Consumer data allow political



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paigns to identify “the political and social DNA of a person,” says Ron Fournier, editor-in-chief of Hotsoup.com, a bipartisan political Web site, and co-author of the book *Applebee’s America: How Successful Political, Business, and Religious Leaders Connect with the New American Community*. The sliced-and-diced data allow campaigns “to control the message and identify which issue is most likely to be the most compelling for each household at every life stage,” says Josh Herman, director of product innovation at Arkansas-based Axiom Corp., the data company used most often by campaigns from both parties. For the DeVos campaign, the result is “a matrix to hit our most likely voters,” says Communications Director John Truscott.

Matthew Dowd, chief strategist for President George W. Bush’s 2004 campaign, says the ascendancy of corporate-affinity politics is the culmination of a profound change in the way people reach political decisions. Party loyalties are waning. Voters are more likely to share “gut values” that result in product loyalty. “Today, you have to understand the lifestyle choices they make, what products they buy, where they choose to live,” Dowd says, “or you’re going to miss the boat.”

Consumer data and political polling offer a glimpse into consumers’ psyches. Applebee’s restaurant patrons tend to be middle class residents of the heartland who value family, community, and consistency. A Wal-Mart Stores shopper is likely to be socially conservative, pro-gun, and exurban or rural, while a Bloomingdale’s or Neiman Marcus customer is probably upscale, urban, and socially liberal. A Target regular is an independent-minded, style-conscious, cost-conscious suburbanite. That makes Target customers “the sort of voters who are at play in swing states,” says Steven E. Schier, a political scientist at Carleton College.

## KNITTERS LIKE BILL

BUSH ADVISER DOWD says lifestyle targeting allows campaigns to identify supporters with 90% reliability, compared with under 60% for old-style targeting based on factors such as geography or ethnicity. That’s why campaigns will sometimes pay more than \$100,000 for that kind of information and tens of thousands more to massage and update the data. Rounding out the hefty budget is a million dollars or more to reach the micro-targeted audience.

Companies have used data mining for

years to study the personal traits of their most loyal customers and to develop strategies to expand their reach. But it’s relatively new to politics. In 1996 President Bill Clinton’s reelection strategists noticed that basketball fans, knitters, and daytime talk-show viewers were supporters, while fans of country music, college football, and the TV comedy hit *Friends* favored Republican Bob Dole. But the campaign did little with the data other than target TV programs for ad buys. In the intervening years, Republicans recognized the benefits of adapting costly business models, while “Democrats have

cation and transportation. That helped him win not only the Target swing vote but also many socially conservative customers of Applebee’s and Wal-Mart. C Election Day, Kaine swept the suburged Republican Jerry W. Kilgore on the home turf of religious broadcaster P. Robertson, and captured an unprecedented 47% of the votes of white, churchgoing mothers—normally a very Republican voting bloc.

Campaign manager Mike Henry says the consumer data allowed the Virginia “to be very efficient with time and resources. It allowed us with pinpoint acc

## Pinpointing Customers

Corporate-affinity politics is on the upswing as campaigns try to craft messages that appeal to the values of groups of consumers. A few examples:

**WAL-MART** Regular Wal-Mart shoppers care about family values, tend to be socially conservative and economically populist, and want value for their dollar. They voted strongly for Bush in 2004, but Democrats who talk about faith and family can do well.



**STARBUCKS** Slightly upscale and hip, Starbucks customers value quality. They cross the political spectrum but lean Democratic, like the urban areas most coffee shops occupy.

been behind the curve,” says former Clinton political director Douglas B. Sosnik.

In 2004, the Bush campaign used consumer data to target both core supporters and swing voters with a higher degree of accuracy than had ever been achieved. Dowd’s plan helped Bush turn out the Republican base in record numbers while besting Democrat John Kerry among coveted swing blocs such as blue-collar men and suburban women.

Just last year, Governor Timothy M. Kaine (D-Va.) used consumer data to identify key swing voters and tailor his faith-and-family message to attract suburban Starbucks customers and exurban Wal-Mart shoppers alike. Many of those voters lived in the state’s rapidly growing exurbs. In 2004, George Bush outpolled Kerry by nearly 2 to 1 among white, suburban, churchgoing mothers in Virginia. But Democrat Kaine, a former missionary, targeted those voters with a values-laden message that also emphasized edu-

### APPLEBEE’S

The casual dining chain’s customers are a slice of Middle America. They share values of community, authenticity, and consistency. These voters are major targets of candidates from both parties.

**TARGET** Politicians see Target customers as a cross-section of suburbia. Although their incomes tend to be above average, they want both style and value. Politically, they are the quintessential swing voters.

Data: Pew Research Center and Zogby polling, consumer

racy to reach out and touch people.” Henry says Kaine crafted a platform that appealed to these persuadable voters; allowed him to communicate with individual voters about issues that concerned them, such as suburban sprawl.

Already, potential 2008 President candidates like Democrats Mark Warner and Wesley K. Clark and Republican John McCain are studying the technique. Jeb Brodnitz, campaign pollster for Kaine, said the Virginian’s use of consumer data was “version 1.0” for the political world. By 2008, “I assume every [President] campaign will have some kind of mining. It has matured that much.”

One businessman wonders what’s been taken so long. “It’s much the same thing whether you’re looking to influence a son to come to Applebee’s or to vote,” says Lloyd L. Hill, board chairman of Applebee’s. “I don’t know how anybody going to be successful in the future without using data mining.” ■



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# Traffic Cops Of the Net

Somebody has to keep all those billions of bytes moving. Chances are, it's Akamai

BY WILLIAM C. SYMONDS

**F**OR WEEKS, TECHIES WERE abuzz with speculation about Apple's plans to move into movies. And at a Sept. 12 announcement, CEO Steven P. Jobs didn't disappoint, telling a packed audience of journalists in San Francisco that Apple will begin by offering downloads of Walt Disney Co. films. But for many investors, an equally intriguing story has been the company that will make sure all those billions of video bytes don't bring Apple's iTunes Web site to a grinding halt.

Few tech companies have been hotter over the past year than Akamai Technologies Inc. It's a prime example of the rich profits that can be made on the Web's plumbing—the data centers, servers, and

services that keep rising levels of data traffic moving smoothly. The Cambridge (Mass.) company, which employs complex math equations and thousands of scattered servers to ship packets of data efficiently to Web surfers, saw its sales explode by 56% in the second quarter. Sales should top \$400 million by the end of the year. The company is almost obscenely profitable, with operating margins of more than 30%. Its stock has tripled, to about 43, over the past year.

And if you believe CEO Paul Sagan, 47, cousin of the late scientist Carl Sagan, there are billions and billions more dollars

where those came from. Akamai's customers include 29 of the top 30 media and entertainment companies, most of the top social networking Web sites, more than half of the top 50 Internet retailers. Those companies are falling on each other to add video downloads, social networks, and interactive games, each of which hog bandwidth. The average movie takes up about 300 times the space of a typical song, so you get an idea of how crowded the Web is getting. "If we talk of the ultimate opportunity as a year," Sagan says, "we're still in early January."

## FENDING OFF RIVALS

THE ONLY QUESTION seems to be how much of that opportunity will fall to Sagan and his team of math wizards and server jockeys. Akamai now controls well over half the content distribution market, but competitors are swarming. Some are smaller companies that mimic Akamai, like Arizona-based Lime Networks, which raised \$130 million in a financing round by Goldman Sachs in July. Others push a rival and cheaper—technology known as peer-to-peer—the chief worry is the prospect of big Web outfits like Microsoft and Yahoo! as Akamai customers deciding they need to take the market themselves.

Akamai got its start when Tim Berners-Lee

**Small rivals are landing on Akamai's turf. Net giants may follow**



September 2006

## **Our Commitment to Customers of McDATA and Brocade**

Dear Valued Customers,

As an important part of Brocade's recent announcement to acquire McDATA, we want to assure you of our continued commitment to provide the high level of customer service and high-quality products you have come to expect. After the acquisition closes and we are able to operate as a combined entity, we will be focused on the following key areas:

### **Ongoing Product Supply**

- We plan to continue to deliver and support both McDATA and Brocade SAN directors, at least until Brocade delivers a converged, next-generation platform.
- We will provide visibility into the anticipated life for all products along with a detailed product roadmap after the acquisition closes.

### **Interoperability Solutions**

- We will continue providing interoperability between Brocade and McDATA SAN fabrics with our routing products and plan to invest in native interoperability solutions.

### **Unified Management Tools**

- We will also continue providing the free Brocade SAN Health diagnostic utility, which is already being used by hundreds of McDATA customers.
- We also plan to deliver SAN management solutions that incorporate the key functionality of both McDATA EFCM and Brocade Fabric Manager.

### **Migration Tools and Services**

- We plan to provide tools and professional services to simplify migration to new SAN platforms or technologies.

### **Outstanding Technical Support**

- We will continue providing the highest-quality technical support and will honor all existing contractual support commitments for both companies' products.

Brocade and McDATA will continue to operate as independent companies until the acquisition closes. We continue to value your input on how we can best serve your needs. If you have any questions or comments, please contact your current McDATA or Brocade sales representative or visit [www.brocade.com/welcome](http://www.brocade.com/welcome). Thank you for your confidence in Brocade.

Sincerely,

**Michael Klayko**  
**Chief Executive Officer**  
**Brocade Communications Systems, Inc.**

[www.brocade.com/welcome](http://www.brocade.com/welcome)

Additional information about the acquisition, and the interests of the participants in Brocade's and McDATA's solicitation of proxies in connection with obtaining stockholder approval of the acquisition, will be included in Brocade's registration statement on Form S-4. The Form S-4 will be filed with the SEC and available on the SEC's Web site at [www.sec.gov](http://www.sec.gov). In addition, this advertisement contains forward-looking statements, including information regarding Brocade's product plans, which are subject to risks and uncertainties as described in Brocade's annual and quarterly reports filed with the SEC and available at [www.sec.gov](http://www.sec.gov).

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the man credited with creating the World Wide Web—walked down a hallway at MIT and warned math professor Tom Leighton that congestion would become a huge problem once the Web took off. Leighton started working on algorithms with one of his graduate students, Daniel Lewin, in 1995. “I love large problems,” says Leighton, “and this was ideal” because of the Web’s grand scale. Three years later, Leighton and a team of 30 math and computer experts, most from MIT, had come up with the core solution, and they founded Akamai.

## BOOM TO BUST

THAT SAME YEAR, Sagan arrived as something of a misfit in this geek paradise. The son of a newspaper executive, he attended Northwestern’s Medill School of Journalism and at 28 was the youngest-ever news director for WCBS-TV in New York. But Sagan plunged into the just-emerging Internet in 1995 as president and editor of new media for Time Inc. There he founded Pathfinder, a star-crossed site that helped pioneer Web advertising, and Road Runner, the first broadband cable-modem service. Sagan started as Akamai’s president and became CEO in April, 2005.

To understand Akamai’s role, consider how the Internet works today. It comprises a staggering 15,000 different networks, ranging from the Internet backbone of Level 3 Communications to a small network run by the University of Chicago. That’s double the number of networks that were operating in the late ’90s, and all of them must interact for the Net to function smoothly. If all iTunes customers were sent to Apple’s servers in California, the servers would soon be overwhelmed with requests. So Akamai distributes iTunes’ song, video, podcasting, and audio-book catalog to its network of more than 20,000 servers, which are placed on the premises of Internet service providers and other network operators across 70 countries. (Most are happy to host Akamai’s servers without charge, to help their own nets run smoothly.) Complex algorithms direct each



customer to the Akamai server that can best handle their request. Usually, it’s right in the same community. Without Akamai, Coldplay’s song *Speed of Sound* would move like a tortoise.

Akamai generally charges by the number of megabits it transmits, with some volume discounts. For some Web sites,

especially those powered by user communities, a few seconds of transmission speed can be crucial. Late last year the social network site Friendster was getting killed as customers had to wait seemingly forever for pages, some with hundreds of photos, to load. So it turned to Akamai. By March, Friendster’s response time was slashed from 9.4 seconds to 3.4.

Like other Net infrastructure plays, Akamai got swept up in dot-com fever. Following its 1999 IPO, the stock price soared from \$26 in late October to \$345 on New Year’s Eve. But when the Internet bubble burst, many of Akamai’s customers went bust or just disappeared. Then Lewin was killed on September 11 on American Airlines Flight 11, which crashed into the North Tower of the World Trade Center in New York. In 2001, Akamai lost \$2.4 billion; a year later,

the share price bottomed just 56¢.

Akamai’s resurgence has been fueled by household-name businesses crowding onto the Web and their growing realization that speed and reliability are essential for drawing mainstream users. Its customer list includes the Transportation Security Administration. On Aug. 10, after the agency imposed stringent new carry-on limits following a plot to blow up flights with liquid explosives, hits to its Web site surged to 15.4 million, from 500,000 the day before, without a blip.

## CUSTOMER COMPETITION

BUT AKAMAI’S STOCK multiple—it trades at 52 times expected 2006 earnings—makes it a rich target. Small rivals Veeva Stream and Limelight are enjoying blistering growth; Veeva Stream’s \$6 million revenue

in the second quarter were just 6% of Akamai’s, but they rose 57%, and its customers include MySpace and Walt Disney. Limelight co-founder and chief strategist Michael Gordon claims that by clustering hundreds of servers in a few locations he is actually better positioned to deliver big video files. Not surprisingly, Akamai dismisses that as marketing hype. Still, Limelight has picked up such notable customers as YouTube.com and the new movie service from Amazon.com.

A bigger threat, though, could be looming from Akamai’s own customers. Right now, Microsoft and Yahoo! are both clients; Akamai says it is allowed to discuss Google Inc., which leads some analysts to believe it’s one well. Google declines to comment, other than saying it handles its own video distribution. But with those companies spending a fortune to build data centers and other infrastructure, some insiders believe they’ll feel compelled to jump into content distribution to get a return on their investment.

Robert Stimson, an analyst at Hambrecht & Co., reasons that this market is going to become very large, he is strategic, to the major tech companies. “If you’re Microsoft or Google, you want more control over this.” Microsoft declines to comment, other than to point to its “mutually beneficial” relationship with Akamai. But the low-profile domain Akamai now dominates could become new as crowded as the Internet itself. ■

## A Need For Speed

The Web will only get more crowded as sites crank up video offerings.

TYPICAL MUSIC FILE

5

MEGABYTES

TYPICAL MOVIE FILE

1,500

MEGABYTES

TOTAL VIDEO STREAMS, 2005

1.5

BILLION

TOTAL VIDEO STREAMS, 2011\*

6.7

BILLION

\*Estimated  
Data: Akamai Technologies Inc./  
Yankee Group



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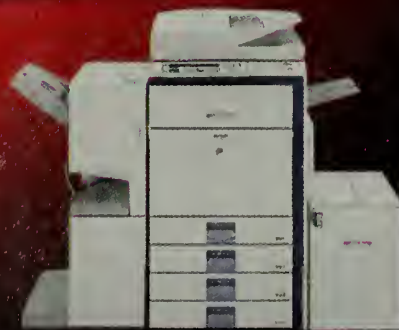


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# If I Had a Nickel for Every Click...

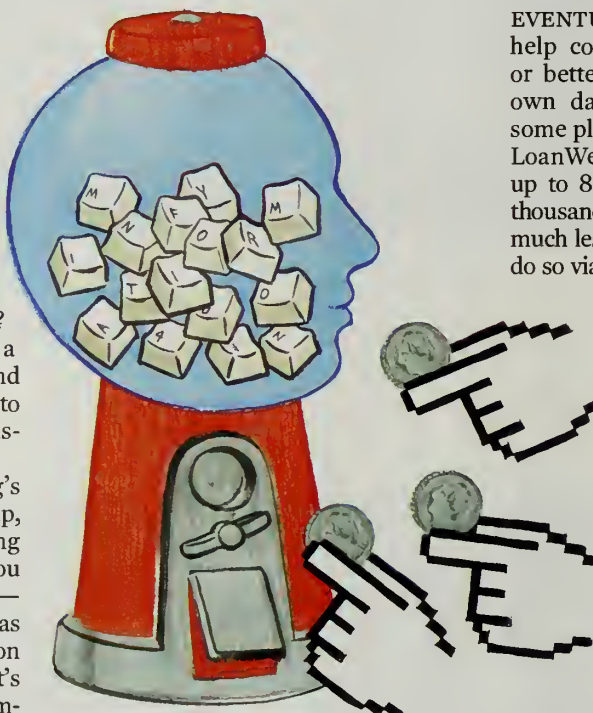
A new service could help users control—and profit from—the data they generate online

BY ROBERT D. HOF

**L**ET'S SAY YOU WANT A home loan, and you take a few minutes to fill out one of those annoyingly ubiquitous Web mortgage applications from LendingTree or LowerMyBills.com. All that personal data you just provided to those middlemen? It's now a lead, a valuable referral to a prospect (you) who is primed to respond to an offer. And it's worth up to \$75 to mortgage providers seeking new customers. Your data. Their money.

Seth Goldstein thinks something's wrong with that. His New York startup, Root Markets, aims to turn marketing and advertising inside out by giving you the power to control your online data—including what you pay attention to as you traverse the Internet. "Your attention has literal value," says Goldstein, Root's founder and chief executive. "Consumers, based on their attention, are creating more and more of the value on the Internet." He notes that Google Inc.'s \$115 billion market value is largely based on its ability to divine when a searcher intends to buy something and run a relevant ad next to search results.

For starters, Root helps consumers track their online activity. Using an add-on to the Firefox Web browser called Attention Recorder, you can track your searches on Google, all the sites you click on, and more. You store it all in a private online "vault" that you'll be able to share selectively with others—such as marketers. A mortgage provider, for instance, might pay you a nice sum if you let it know you just ordered *Home Buying for Dummies* from Amazon, signaling you'd be open to seeing a loan pitch. The upshot: Soon you may be able to turn your digital bread crumbs into real dough.



## Online Lead Generation Takes Off

2004 REVENUES

**\$288\***  
million

2005 REVENUES

**\$750\***  
million

\*Money paid for referrals to Web users who have agreed to be contacted by marketers

Data: PricewaterhouseCoopers, Interactive Advertising Bureau

You could, that is, if there were an easy place to offer up those bread crumbs to marketers. So Goldstein, the founder of the early online ad agency SiteSpecific Inc. and most recently co-founder of boutique research firm Majestic Research, last year

formed a service he calls the Root Exchange—the first marketplace for trading Internet leads. The executive chairman and a chief investor in Root Markets, the tune of \$5 million, is Lewis S. Ranieri, who created the now \$5 trillion market for mortgage-backed securities. It's not surprisingly, Root Exchange is currently focused on mortgage leads, using a lead-generation company Root Markets bought last year. Root takes a 5% sales commission on each lead. Goldstein plans to move into other leads, such as auto loans and insurance.

### NO MIDDLEMAN

EVENTUALLY, GOLDSTEIN hopes to help consumers, in return for more or better deals, offer up more of their own data to create better leads. For some players already like what they see. LoanWeb.com, for instance, now sends up to 8% of its daily volume of several thousand leads to Root Exchange, paying much less to reach lenders than it costs to do so via Google ads. Lead buyers such

as SCENA Mortgage Group of San Jose, Calif., find it cheaper to order leads from the exchange than to go to several middlemen. "Root Markets has revolutionized how we reach customers," says Brian H. Dricks, SCENA's vice-president for marketing.

Now, Goldstein is about to push the concept even further. On Sept. 15 Root will join with the Chicago Board of Trade, which will invest \$1 million in the company, to generate investment products from the trading activity on Root Exchange. Starting next year, in much the same way Ranieri packaged bundles of mortgages themselves and sold them as investment vehicles to institutional investors, Root Markets and the CBOT aim to create futures markets based on consumer Internet leads. "We see a very interesting product opportunity in a whole variety of sectors," says CBOE CEO Bernard W. Dan. In other words, they literally intend to create new markets out of consumers' online attention.

If all that sounds audacious, it is. Explaining to Web shoppers how and why they should keep track of their online travels, let alone how they could make money from that, won't be easy. "It's going to be difficult for consumers to understand," says Brad Strothkamp, an analyst at Forrester Research Inc. And it will even more difficult to get them to take trouble—even for a little coin. ■

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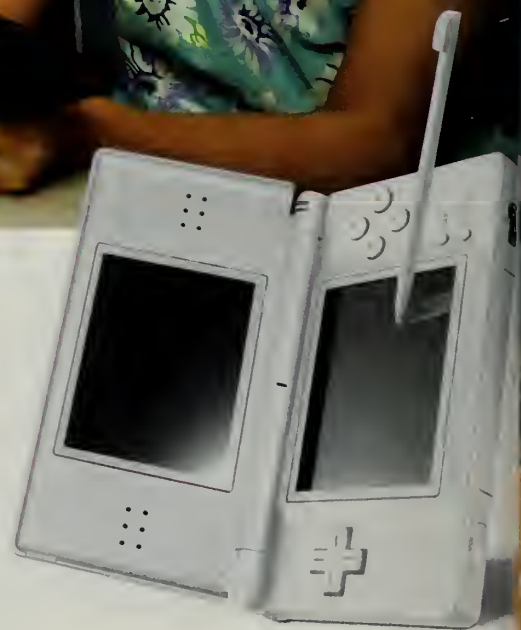
## GOOD ONE, GRAMMA

Marge Stajk, 75, and granddaughter Riley Somerville, 6, try out *Brain Age* on the Nintendo DS at the company's Manhattan store



# Chicken Soup for The Aging Brain

The disputed idea that mental exercise can turn back time has launched an industry



BY CATHERINE ARNST

**T**HE GIANT NINTENDO store in Manhattan was swarming with silver-haired citizens and their grandchildren. The elders, gathered on a recent Saturday, weren't there to spoil the kids, however. Nintendo was hosting a video game competition to determine the "Coolest Grandparent," and the aging gamers in the store were competing for a Nintendo DS handheld game player. They weren't playing *Super Mario Bros.* either, but a product called *Brain Age*, a mind challenger targeted at one of

the fastest-growing segments of the game market: people over 40 worried about losing their mental edge.

Meanwhile, at The Hallmark retirement community in Chicago, 16 residents just completed a complex memory training program developed by neuroscientist Michael Merzenich of the University of California at San Francisco. While *Brain Age* advertises that it can "train your brain in minutes a day," the Brain Fitness Program, marketed by Merzenich's Posit Science Corp., is a computer-based set of exercises that a user must sit down with an hour a day for eight weeks.

Posit executives are emphatic that

their programs are not video games, and the company published a scientific study in August that lays out the memory-enhancing bona fides of Brain Fitness. Hallmark resident Sadelle T. Greenblatt, 85, is already convinced. After going through the Brain Fitness course she says, "my memory, I think, is in some ways better. When I play bridge now, I can always remember if all the trumps are out."

Nintendo and Posit are both profiting from the memory decline that is one of more disquieting markers of aging. As baby boomers march toward senior citizenship, hiding their mental age may prove as important to them as concealing their





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hair. Nintendo says its recent emphasis on what it calls "gray gamers" already pushed second-quarter profits up eightfold.

The industry must face down one potentially large obstacle, however. There is no empirical proof that brain teasers, crossword puzzles, or any of the other mental exercises out there will slow mental decline, or thwart Alzheimer's disease.

Efforts to improve the aging mind are one of the more contentious areas of science. Shelf after shelf of books call on seniors to "use it or lose it," arguing that brain activity will prevent cognitive losses. So far, it's only a catchphrase. Last spring, University of Virginia neuroscientist Timothy A. Salthouse analyzed a large number of studies meant to show that mental challenges arrest brain decline. He found none that proved its thesis. So far, he concluded, "the mental-exercise hypothesis is more of an optimistic hope than an empirical reality."

## "LITTLE EVIDENCE"

SALTHOUSE DISCOVERED that most brain-training studies suffer from a "chicken or the egg" problem. It could be that people who performed well in studies involving mental exercises were more mentally agile to begin with. It is true that practice makes perfect, says Matthew L. Shapiro, a neuroscientist at Mount Sinai School of Medicine in New York. "The more you try to remember, the better your skill at remembering." Still, he says there is little evidence that those improvements will lead to overall mental improvement, and a brain disease "will ultimately overwhelm any efforts to better your skills."

The most skillful game-playing grandparents at the Nintendo event were proof that practice pays off. Lynn Lipton, a 66-year-old retired teacher from Poughkeepsie, N.Y., says she has been an avid video gamer since *Pong* was introduced some 30 years ago. "I don't have the data to prove that it helps my memory, but I know it helps me to read faster. It keeps me sharp," she says.

Not everyone can make that claim at 66, which is why brain training is getting so much attention. The human brain reaches its maximum weight by the age of 20 and then slowly starts shrinking. By age 50 or so memory formation usually slows down, and by 70 some 12% of the population suffers from mild cognitive impairment (MCI), characterized by frequent short-term memory

## Retiring Minds Want to Know

Can memory and cognition be improved?  
Two renowned scientists say yes



**DR. RYUTA KAWASHIMA**

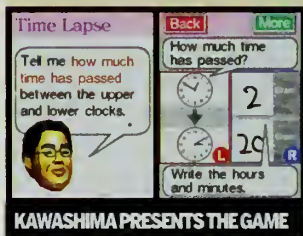
Tohoku University, Sendai, Japan

### THEORY

Kawashima

believes that solving a number of rapid-fire, simple problems such as basic arithmetic will engage the entire brain, keeping the mind agile.

**PRACTICE** Nintendo created *Brain Age* games for handheld players, a series of simple problems to be played 15 to 20 minutes a day.



KAWASHIMA PRESENTS THE GAME

**MICHAEL MERZENICH**

University of California at San Francisco

### THEORY

Merzenich believes intense, weeks-long training with complex computer programs can rewire elderly brains, significantly improving memory with lasting effect.

**PRACTICE** Merzenich helped create Posit Sciences' Brain Fitness training program, performed an hour a day for eight weeks.



POSIT'S EIGHT-WEEK PROGRAM

lapses. People with MCI are three to four times more likely than their peers to develop Alzheimer's disease.

For decades, researchers thought that little could be done once the brain started to decline. But in the early 1990s Merzenich and others discovered that the brain remains plastic throughout life. With training, it can be rewired to learn new skills. From this discovery grew the belief—now an industry—that the aging brain can be taught to be young again.

Nintendo is quick to disavow any scientific claims for its *Brain Age* games, which cost \$19.95 each. "We're in the entertainment business," says Perrin Kaplan, head of marketing for Nintendo's U.S. operations. But Nintendo does boast that *Brain Age* was developed with the help of Dr. Ryuta

Kawashima, a respected Japanese neuroscientist whose face pops up at the start of every game. Kawashima believes brains can be kept young and nimble through the rapid repetition of simple mental chal-

lenges. The game wildly popular in Japan, and 4 million copies have been sold worldwide since *Brain Age* was introduced months ago.

Posit, founded by Merzenich in 2003, all about the science. He lends the company plenty of scientific street cred; he mentions some of the key findings about brain plasticity, helped pioneer cochlear implants, and developed well-regarded training programs for children with learning disabilities. He says his \$10 Brain Fitness program is grounded in hard data.

This summer Posit released two studies that Merzenich says prove its worth. One involving 182 healthy people 60 and older assigned half the group to Posit's brain exercises for eight weeks. The rest

asked only to watch educational DVDs. The researchers found that 93% of the Brain Fitness group significantly improved their memory function, while the control group did not.

In a second study released this summer, Posit's program was tried on 45 people diagnosed with MCI. PET scans of brains of 15 participants were taken before and after the study. There was no evidence of memory gains in the Brain Fitness group, and the PET scans revealed a decline in brain activity in those who did not use the brain exercises. Brain activity held steady for the "We've seen 80-year-old people improve from being sluggish and slow to having the mental performance level of a 70-year-old," says Merzenich.

Whether these people will be able to stave off further cognitive decline remains to be proven. Salthouse, at the heart of his paper debunking such efforts, wrote that there's no harm in trying. If there is no beneficial evidence, however, engagement in such mentally demanding activities at least serves as proof of competence: "If you can still do it, then you know that you have not yet lost it."

## Boomers want to hide both their gray hair and their mental age



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# Why Peter Dolan Got the Boot

Warding off generics makers can be tricky for a Big Pharma boss. Ask Bristol-Myers' ex-CEO

BY JOHN CAREY

**O**NE CRUCIAL TEST OF A drug company is how well its executives fight the patent wars. Patents ensure that successful drugs reap monopoly profits, but those monopolies are often fragile and open to challenge. That drives pharmaceutical companies into a high-stakes game of chicken. Right choices can bring billions in revenues. Wrong decisions can send stocks plunging—and cost CEOs their jobs. That's what happened to Bristol-Myers Squibb Co.'s Peter R. Dolan, who was ousted on Sept. 12.

Dolan's latest sin was to botch a patent fight with Canadian generic drugmaker Apotex Inc. over BMS's blockbuster anti-clotting drug, Plavix. Worried that he might lose the fight, Dolan tried to pay Apotex to prevent the generic maker from coming to market. But the move backfired: Starting on Aug. 8, Apotex flooded the market with millions of generic copies of Plavix, slashing BMS's current and future sales by hundreds of millions of dollars. The great irony is, Dolan never had to pay Apotex in the first place. According to an Aug. 31 ruling in U.S. District Court, the Plavix patent wasn't as vulnerable as Dolan had feared.

The story offers a window into the larger struggle within the industry, and between the

industry and those who regulate it. Because so much hangs in the balance, brand-name companies are constantly pushing the envelope on schemes to extend their patent protection and thus keep cheaper generic drugs off the market. And just as surely, generic drugmakers seek ways to shorten the monopolies. The referees are the courts and the regulators who want to help consumers by boosting competition.

## HUGE PAYDAYS

IN THE LATE 1990s and early 2000s, the Federal Trade Commission largely prevented brand-name companies from pay-

ing would-be generic competitors. the agency lost a key court case in 2001 opening the door to such settlements. For this year, 7 out of 10 agreements between brand-name and generic companies involve payments in exchange for delays in marketing generic drugs according to the FTC.

These battles wouldn't take place if the world of patents were a simpler, more certain place. Here's how it's supposed to work: Drugmakers get patents on innovative drugs. The patents expire 20 years after they're filed. When the patents expire, generic competitors hit the market.

But because patent protection is so creative, brand-name companies do everything they can to keep it going. They get patent extensions. Or they file additional patents, covering what they call are crucial new details about a drug, such as the way it's made. Bristol-Myers Squibb has been particularly aggressive in its pursuit of strategies for extending patent life. One long-running joke in the industry is that the company must spend most of its research and development budget on patent lawyers. A payoff from even a few months of a partial monopoly on a blockbuster drug—far more than the annual sales of most drugs.

In the case of Plavix, BMS's current

## Dolan's Waterloo

Mishandling of the patent on the clot-busting drug Plavix brought down Bristol-Myers Squibb's CEO. Here's how events conspired against him:

**EARLY 2000s** The Federal Trade Commission takes a hard line on deals in which brand-name drug companies pay generic competitors to stay off the market

**2001** Canadian drugmaker Apotex applies to sell a generic version of Plavix, saying the patent on the drug is invalid

**2005** Appeals court rules against FTC on a payment deal, emboldening companies to do more of them

**JANUARY, 2006** Regulators approve generic

Plavix, and Dolan discusses a deal to pay Apotex to delay entering the market

**JULY, 2006** State attorneys general nix the deal

**AUG. 8, 2006** Apotex launches generic Plavix, and Bristol-Myers quickly sues to block it

**AUG. 31, 2006** Judge sides with Bristol, blocking further distribution of the drug, but too late to keep Bristol from taking a major sales hit

**SEPT. 12, 2006** Dolan is asked to step down



**BAD CALL**  
Dolan says the Plavix patent was vulnerable

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er, Sanofi-Aventis, originally had patent that covered a whole class of drugs of thousands of chemicals with varying anti-clotting properties. One became Plavix. The patent expired in 2003.

When Sanofi tried to develop drugs some of those compounds, it made a discovery: Many chemicals come in right- and left-handed forms. These

images are visually identical but can have different biological properties. It found that a right-handed chemical, known as Plavix—is as effective and less expensive than either the left-handed version or a mixture of both. Its patent on that right-handed version, however, expires on Nov. 11.

Generic drugmakers might wait until after that to market a generic Plavix. But generic patents are weaker than others. So a generic company might take a risk and file a legal challenge, claiming that the patent is invalid or unenforceable, or isn't

strong enough. The track record of such challenges is surprisingly good. According to a CBO testimony, from 1992 to 2000, generic drugs prevailed in cases involving 73% of challenged drug products." Apotex, for example, got a generic Paxil (once a \$2.2 billion per year antidepressant) on the market in 2003, even though Glaxo-Kline PLC claimed patent protection until 2017. Clearly, many of the follow-on drugs are vulnerable.

## CALCULATIONS

WITH SUCH a challenge, brand-name companies must make a decision. "It's a difficult calculation," says Robert Lipp, spokesman for Cephalon Inc., "but it makes the wakefulness drug market and has settled with four generic companies.

If the patents are strong, a brand-name company will fight. But if the patents don't hold up in court, it could be easier to make a deal. The deals can take many forms, and some settlements in sharing the monopoly profits with a generic drugmaker.

Until recently, that strategy ran afoul of the FTC, which sees such deals as anti-competitive. But the FTC has had its own woes. A complaint it filed against a deal done by Schering-Plough Corp. was struck down in a 2005 court ruling. Ever since, drugmakers have felt emboldened, and deals are proliferating. The FTC is now scrutinizing these deals, and seeking a strategy for discouraging them.

Perhaps Dolan might have been able to get away with paying Apotex. But he had two big problems. First, Bristol-Myers Squibb was already in trouble with state attorneys general for allegedly padding quarterly earnings by overloading wholesalers with inventory. As part of a deferred prosecution agreement with the U.S. Attorney in New Jersey, Dolan agreed to submit to the scrutiny of a court-appointed outside monitor, former federal judge Frederick B. Lacey.

Second, the deal he struck with Apotex had major miscalculations. To reduce the

risk for itself in case regulators nixed the deal, Apotex insisted on big concessions. In one of them, Dolan agreed not to go to court to try to stop Apotex from selling a generic Plavix for five business days after it hit the market.

When the attorneys general and the FTC opposed the deal, the concessions kicked in. In its five-day window, Apotex had time to pour many months' supply of its drug onto the market before the courts forced it to stop distributing.

To the U.S. Attorney for New Jersey, Dolan's decisions in the Plavix matter were incontrovertible evidence of bad corporate governance. The biggest mistake of all, though, was misreading the strength of the patent that expires in 2011. In his Aug. 31 ruling, U.S. District Judge Sidney H. Stein gave every indication that BMS would prevail in the patent fight. "In hindsight, maybe we shouldn't have negotiated in the first place," says Bristol's board chairman, James D. Robinson III.

Because of all these mistakes, the outside monitor, Lacey, had every right to kick Dolan out—and he did. ■



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# Cleared of Murder But Out of a Job

DaimlerChrysler fired Sharon Spangler while she was in jail. Now she's suing



**SPANGLER**  
alleges gender  
discrimination

BY SUSAN BERFIELD

IT WAS THE FALL OF 2002, AND Sharon Spangler was thriving professionally: At age 44, after two decades at what is now DaimlerChrysler, she was earning \$110,000 a year as an engineering supervisor for the Jeep brand. No one at work, or anywhere else, knew that her troubled marriage had turned violent. Then on Nov. 20, a week into a medical leave, she killed her husband and was charged with premeditated murder. While she was sitting in the Lapeer County jail in Michigan, Daimler fired her for a bureaucratic infraction: failing to show up for an evaluation required to continue her leave of absence. In March, 2004, a jury deliberated for five hours and acquitted Spangler of all charges, deciding

she had acted in self-defense. Now she is suing to get her job back.

Although Spangler's suit is unusual, it raises an important question about a company's responsibilities to its employees. Should a business accommodate workers who are unable to adhere to its policies because of their difficult personal circumstances?

Sharon Sewell met Steve Spangler when they both worked at a Dodge truck assembly plant near Detroit in 1983. Sharon had graduated from college, the first one in her family to do so, with a degree in chemical engineering and was hired as a paint-quality engineer on the night shift. The plants were

pretty rough places in those days; he was known as Dodge City. "I was the pervisor," she recalls. "I had the clipboard and the authority, but I didn't know what to do with it. I was terrified."

Members of the "zoo crew," as workers were known, tried to intimidate their soft-spoken new boss. Steve, charming, funny, mischievous, and a factory since high school, came to her defense. Her nickname was "Debutante"; he was "Fuzzy." In 1988 they were married.

Steve took a buyout from Chrysler 10 years later and eventually got into the real estate business in Dryden, a small town 45 miles north of Detroit. They built a

house on 10 acres. Dryden is a hunting community, and Sharon learned to use a gun. She and Steve practiced shooting clay pigeons on the property that had been in the family for generations.

Their hope of having children was crushed when Sharon had to have a hysterectomy in 1999. She says she put off starting a family because she was working longer hours and her managerial responsibilities increased, and there was always the promise of another promotion. In 1995 she had become a supervisor at Jeep engineering, with a staff of about a dozen. And in 2000 she worked as a Jeep Renegade program supervisor.

## STRESSED OUT

STEVE WASN'T doing as well as he had earned his Real Estate license, and his picture

on "For Sale" signs all over town. But he experienced financial difficulties with his own development projects. He burst into anger, berating Sharon, and to apologize later and blame the stress on his business. In 2002, as Steve approached 50, he began taking steroids and diet pills. In a matter of months his waist went from 40 inches to 32 inches. He slept little and always seemed agitated. "Then Fuzzy started shaving off all his hair on his body," she says. Sharon first perplexed, then, as the months passed, increasingly distressed by

## Wife charged in murder

## Wife acquitted

Sharon Spangler

Two home

Spangler alleged that the

through evidence, testimony  
ive for husband's shooting

According to friends and associates, the couple had experienced marital problems for years. Lapeer County

and when I was  
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Snooks appeared to the nose and visibly upset. At 8:42 a



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husband's violence. "A wonderful person was becoming a stranger," she adds. She confided in no one about the fights that turned ugly and twice left her with serious injuries.

As her relationship with Steve deteriorated, she worked more, sometimes staying away for weeks. "Chrysler was good to me," she says. "They never told me to go home. They never asked why I needed a hotel room."

## MENTAL COLLAPSE

AT DAIMLER, SHARON was relieved to be consumed by the demands of the Jeep Renegade launch. But it was only a few months later that her descent began. When a favorite nephew committed suicide, she became distraught. Steve became more aggressive, and she had what she calls a mental collapse. Sharon requested a medical leave from Daimler so she could enter a day-treatment program for depression. A few days later, on Nov. 19, she met with a lawyer to begin divorce proceedings and called Steve, who had moved out, to inform him.



The next morning, as she was blow-drying her hair, her two dogs began barking and she heard someone climbing the stairs. She turned

**When thousands...were losing jobs, it would have been unreasonable to expect any company to hold a job open for a year and a half" —Daimler spokesman Michael Palese**

around to see Steve standing in the bedroom. Their encounter quickly turned violent. According to Sharon, he grabbed her wrists, stomped on her foot, beat her on the head and neck, and threatened to kill her with a gun he had taken from the nightstand by her bed. After a furious struggle, Sharon says she got hold of the pistol and shot Steve once, fatally, in the side. In the hours before he died, Steve told police that Sharon had lured him to the house and then ambushed him. The next day she was charged with murder.

In early January, about six weeks into Spangler's imprisonment, Daimler fired her. Yet its stated reason for doing so is somewhat surprising. Companies are generally free to terminate incarcerated workers for the simple reason that they are unable to show up for their jobs: The presumption of innocence that exists in



**DODGE DAYS**  
Steve and Sharon at their wedding in 1988

after the verdict putting her on paid leave, for ample. "The patience you have to let the fight shake out, the better off you are," says Karl Lirgren, who represents companies in labor disputes. Usually, lawyers

the judicial system doesn't apply in the workplace. And any employer would have reasonable grounds for keeping someone charged with a violent crime off its premises. But Daimler told Spangler, who would remain in jail a further seven months, that she was being let go because she had missed a company-arranged medical evaluation in December. A spokesperson for Daimler, Michael Palese, says that Spangler faced "the same consequence other employees would have."

Spangler's lawyer, Jennifer B. Salvatore in Ann Arbor, maintains that Daimler officials were informed shortly after her ar-

a company should try to find a place for a worker who has been found not guilty.

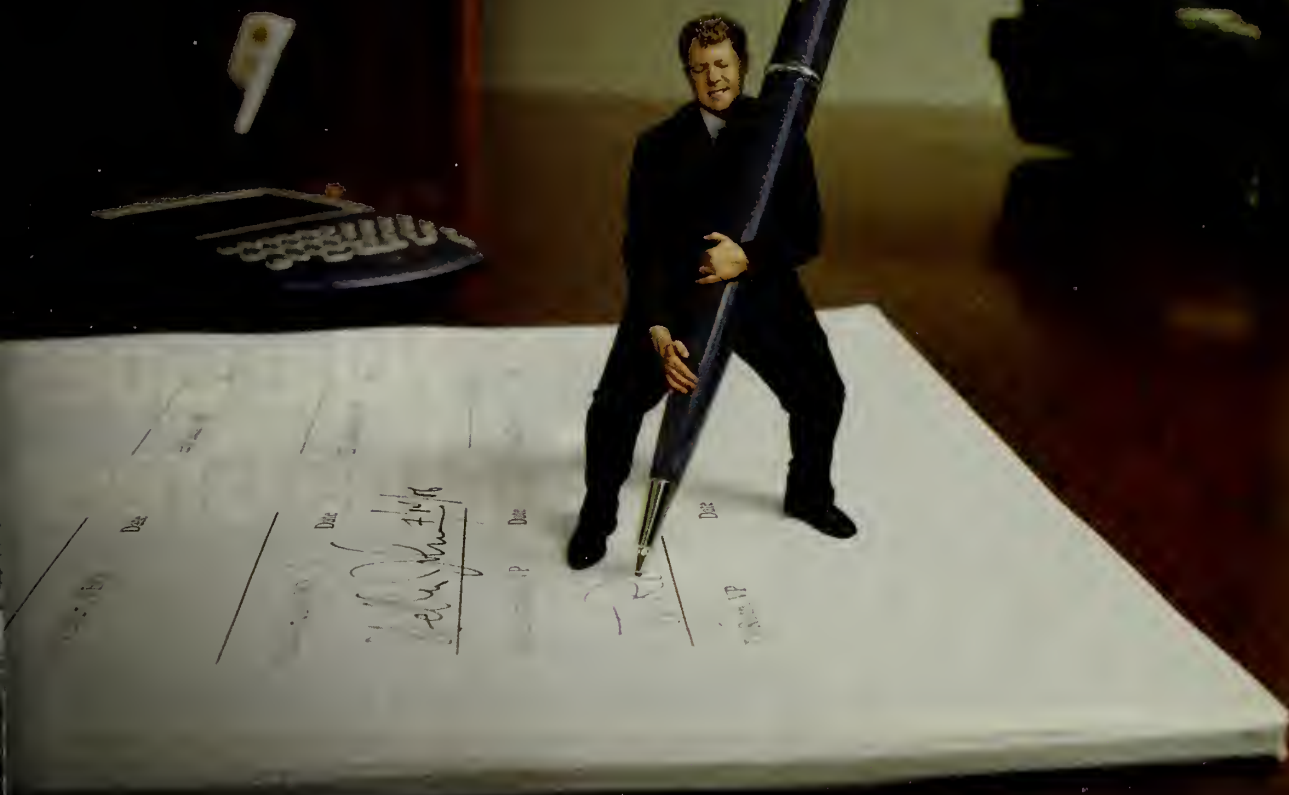
When, in July, 2003, the court released her on bond with permission to work, Spangler says she asked her former supervisor, Vern Schmidt, about coming back. She recalls his telling her to focus on the upcoming criminal trial. He called again after her acquittal. At that point, Schmidt was told by Daimler's man resources department that Spangler should contact the automaker's lawyer.

Palese says Daimler didn't rehire Spangler in the spring of 2004 because her "position was eliminated, along with thousands of others, as a result of DaimlerChrysler's downsizing." He says that "at a time when thousands of workers were losing their jobs, it would have been unreasonable to expect a company to hold a job open for a year and a half." Yet Schmidt would testify in a deposition in May that he had hired Spangler, though not managers, between March, 2004, and December, 2005, before he retired. He also said that he would have rehired Spangler if given the chance.

Spangler filed her wrongful termination suit against Daimler in state court in Wayne County in December, 2005, claiming gender discrimination. Spangler, a female employee, she alleges, was granted leniency in comparable situations. She is also making the novel argument that her dismissal violates a Michigan law that protects the rights of domestic violence victims. Daimler has since gotten the case moved to Oakland County, an affluent and conservative community. The trial is scheduled for June, 2007. After her acquittal, Spangler has been volunteering at a shelter for abused women and looking for a paying job. She says she remains eager to return to DaimlerChrysler: "I think there's still some I can do for the company." ■

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# Nike Goes For the Green

After 14 years, it figures out how to get greenhouse gas out of its sneakers

BY STANLEY HOLMES

**T**O TOM HARTGE, THE FAX that inched out of the machine in Nike's Inc.'s Beaverton (Ore.) headquarters back in 1992 came like a kick to the gut. As the product manager for the company's running-shoe division, Hartge had devoted much of his career to perfecting Nike Air, a lightweight plastic air pocket attached to the heel that had kept the company's sneakers at the front of the pack for more than a decade. Now a German environmental magazine was attacking companies that used a super-potent greenhouse gas called sulfur hexafluoride, or SF<sub>6</sub>. Makers

of refrigerators and air conditioners bore the brunt, but the magazine pointed out that Nike's air pockets contained not just air but SF<sub>6</sub>, too. The accusation stung all the more, coming right as other critics had begun to slam Nike for using sweatshop labor in its contract factories in Asia and elsewhere.

It took Nike nearly 14 years to overcome the SF<sub>6</sub> problem. This summer, after quietly devoting tens of millions of dollars and countless frustrating days to research that went nowhere, Nike finally perfected a way to create SF<sub>6</sub>-free air pockets. The technology now cushions fully half the 200 million shoes it sells each year. Although Hartge and researchers worked closely

over the years with several green groups, they chose not to brag about their environmental victory to consumers or the public. Instead, Nike made the effort as part of a broader strategy to embrace social responsibility without compromising profits or product performance.

The new technology that Nike researchers developed, which uses nitro instead of SF<sub>6</sub>, has even paid off commercially. How? It allowed Nike to create the Air Max 360, the first sneaker to cushion the entire sole with a bed of foam. Launched last January, the \$160 shoe became a hit, and Nike recently rolled out a basketball version. "We wanted to do the right thing for the environment

**HARTGE**  
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# Six Stages to Better Records Management

**T**hese are challenging times for American business. Within just the past few years, thousands of new laws and regulations have been passed aimed at rooting out lax and illegal corporate management practices. The laws serve a vital purpose, of course, but they also create significant new burdens on millions of ordinary companies.

## Consider:

- Sarbanes-Oxley (SOX), the 2002 law designed to strengthen accountability in publicly held firms, imposes an average annual compliance cost of nearly \$7 million, according to The Hackett Group, an Atlanta-based business consultancy.
- The average Securities & Exchange Commission (SEC) fine against corporations has skyrocketed by 400% since 2000, climbing from \$1 million to \$5 million per incident.
- The corporate litigation load has so swelled that the typical \$1 billion company now must juggle an average of some 140 lawsuits at a time.

## The Roadmap to Compliance

As steep as these costs are, there is both comfort and hope in the fact that all public companies face the same new requirements and that, by working together to develop a sound strategic response, firms can minimize or eliminate many of them. The most powerful tool that companies possess in this regard is an effective "Compliant Records Management (CRM) Program"—that is, a program to prudently manage corporate records and documentation. With an effective CRM program in place, companies can fully comply with the new regulatory requirements while operating their businesses with a minimum of interference or interruption.

According to Iron Mountain Incorporated, the Boston, Massachusetts, based leader in compliant records management services, there are six critical stages in the roadmap for building a successful CRM program. The first stage is to **organize** the program by carefully defining the program's governance, implementation, and administration, ensuring that these parameters precisely match the company's needs and resources. The second stage is to **assess** the state of the company's current records program and to inventory the firm's physical and electronic records. Once that inventory is complete, the company then needs to construct a "master plan" for carrying its program forward.

The most critical aspect of this master plan is consistency. Compliant records management systems and processes

need to be established for handling both electronic and physical records in a consistent manner throughout the company—and throughout the records' lifecycle. In addition, standard policies need to be implemented across media types, geographies, and business units.

## The Best Defense

The third stage in the roadmap for an effective CRM program is to **develop** a well-organized and easily understood classification structure that gives authorized managers easy access to corporate records at all times. The reason: when companies are called upon to submit a document, merely having it in the company's possession is not enough; the company also must be able to produce it in a timely fashion. Similarly, companies need to assign retention periods for records based on legal, risk, and operational considerations, and to create a consistent disposition policy so that expired records are destroyed in the appropriate manner and time.

The fourth, fifth, and sixth stages all relate to the CRM program's ongoing operation. Specifically, the program must be **implemented**, typically in a carefully phased rollout that is accompanied by communication and training sufficient to build internal support and knowledge. The program then needs to be **managed** on a continuing basis, and it must be systematically **audited** according to defined metrics in order to ensure its superior performance.

The good news is that, by practicing responsible records management in this way, companies can minimize compliance costs and adverse legal consequences even amid today's strict regulatory regime. Accomplishing this goal won't be easy. But the best defense is a good offense, and in the records management compliance realm, an effective CRM program is the best offense available.

To learn more about creating a successful Compliant Records Management Program, please download Iron Mountain's white paper "The New Corporate Imperative" at [www.ironmountaincrm.com/bw](http://www.ironmountaincrm.com/bw)



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for the athlete, but we wondered if the two could ever be harmonious," says Hartge, 50, now Nike's creative director for advanced research.

Hartge and his colleagues might have been forgiven for dismissing the original complaint as a joke: How could a mere sneaker contribute to global warming? But it didn't take them long to recognize the reality of the accusation. Because SF6 breaks up slowly in the atmosphere, it has an outsize impact when the shoes are finally destroyed and the gas is released from millions of little air pockets. At the peak of SF6 production in 1997, Nike Air

marathoner's tenacity to the task.

The steady setbacks bred inevitable tensions. As the team hunkered down in the Mia Hamm building on Nike's bucolic corporate campus, some worried about getting boxed into a solution that would compromise shoe performance. Others insisted that Nike had to soldier on, both to help the environment and to avoid another sweatshop-type image meltdown.

Meanwhile, Nike's 120-person social responsibility unit had the awkward task of explaining one missed deadline after another to the environmental groups the company had sought out for advice. Nike

plastic into the right shape. "We knew this would be difficult, but we underestimated the challenge," Hartge recalls.

The eureka moment came when the research team realized that thermoforming produced an even tighter seal than blow-molding—one that could hold across a shoe's entire sole. The result: Air Max 360, which offers runners more comfort with less weight. "Thermoforming allows us to shape and create the air sole to the contour of the foot," Hartge says. "We're ecstatic about sales" so far.

Nike's 14-year odyssey came to an

## A GREENER SOLE Nike sees its low-profile victory as a way to avoid the poisonous publicity that accompanied its sweatshop episode



footwear carried a greenhouse effect equivalent to an astonishing 7 million metric tons of carbon dioxide—about as much as the tailpipes of 1 million cars.

Still, there was no way Nike could give up on air cushioning, an innovation it had first introduced as far back as 1978. Those precious few ounces of gas, it turned out, were much better than foam or other heel fillers at absorbing the impact of a foot slamming against the ground. Air—or gas, in this case—also keeps its spring longer. What's more, it's lighter than a solid material, crucial to runners worried about heavy shoes slowing them down.

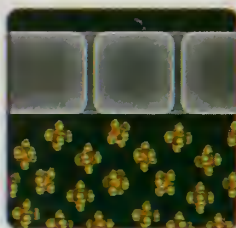
### MISSED TARGETS

UNFORTUNATELY FOR Nike's team of about 60 designers and scientists, SF6 was the ideal gas for all this. Its large, tightly bound molecules rarely leaked after being injected into the plastic pocket attached to a heel. Early on, the group settled on nitrogen as a substitute. But its smaller molecules broke apart more easily than those of SF6 and leaked.

Overcoming the problem bedeviled the team for years as one possible remedy after another led to dead ends. Hartge, who joined Nike in 1981 because of his passion for running, brought a

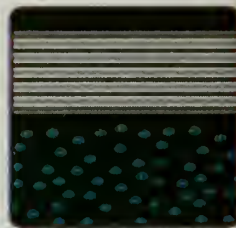
### BEFORE

SF6's large molecules rarely leaked but hurt the atmosphere when shoes were discarded



### AFTER

Layered plastic traps nitrogen's smaller molecules, which break up easily but aren't harmful



missed its first target in 2000, then the second three years later. Still, Nike and the groups maintained good relations, in part because Nike was one of the few U.S. companies to back new European global-warming regulations. "Most of the time we were [siding with the greens] and against the trade and industry groups," says Hannah Jones, Nike's vice-president for social responsibility.

The solution to SF6 finally emerged not in a single breakthrough but in smaller, unconnected victories. After much experimentation, the team was able to hold in nitrogen by sandwiching together 65 wafer-thin layers of plastic film (illustration). Even that wasn't enough, since the old blow-molding manufacturing system wouldn't work with so many layers. Instead, the group refined a technique called thermoforming, which melts the

this past June, when Hartge and Jones proudly informed the environmental watchdog groups that every Nike product line was entirely free of SF6. "We met their goal," agrees Matt Banks, senior program officer for the World Wildlife Fund, which monitored Nike's efforts under a "climate savers" agreement. "This is significant, because [Nike] saw huge cost savings from doing well for the environment."

There are no regulations forcing companies to reduce greenhouse gas, points out Joseph J. Romm, a former EPA Dept. climatologist and the author of *Cool Companies*, a book on major corporations' environmental best practices. "Nike nonetheless decided to take voluntary measures," he says. Just as so Nike now gets raves for the Air Max from runners and greens alike. ■

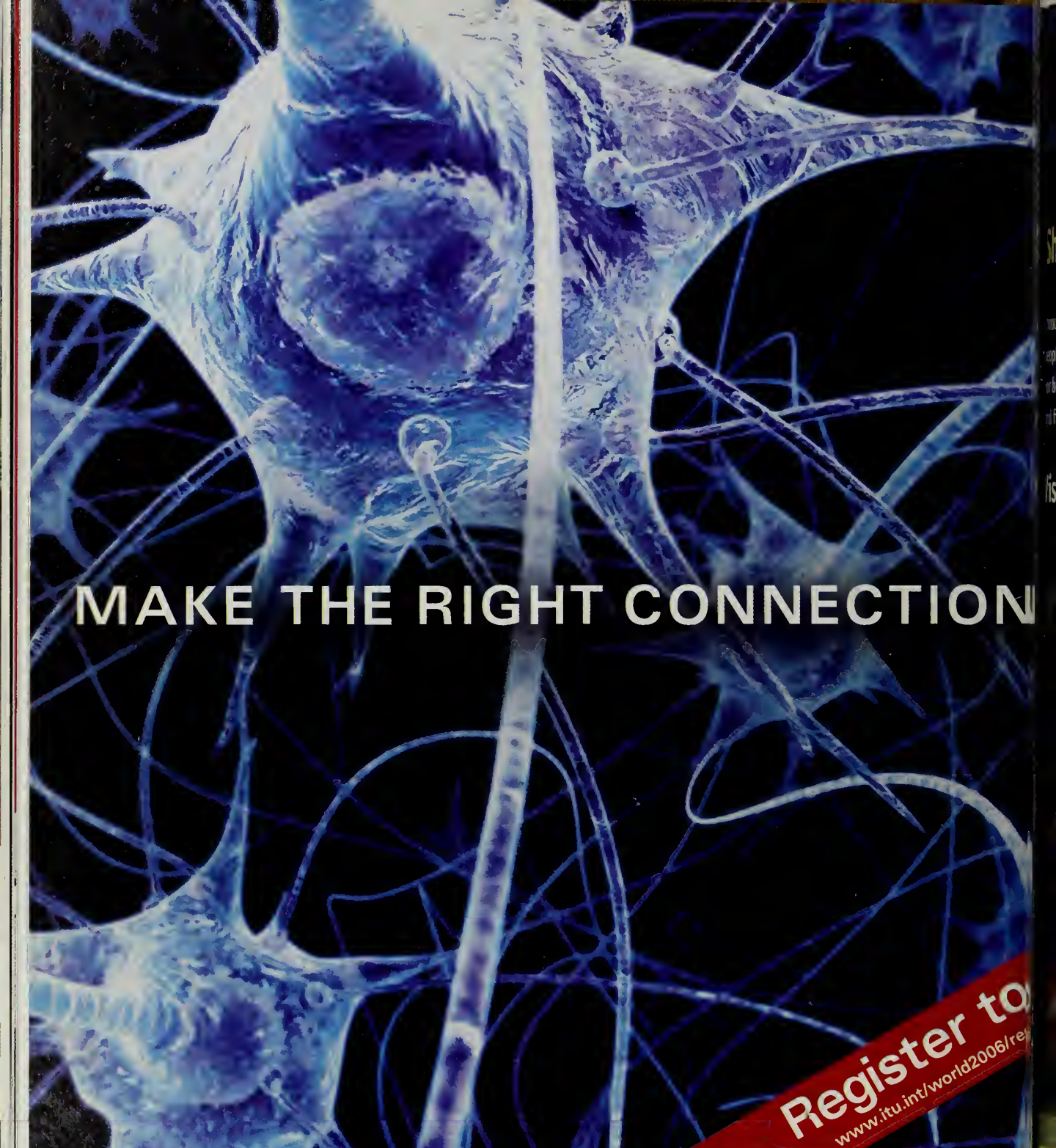


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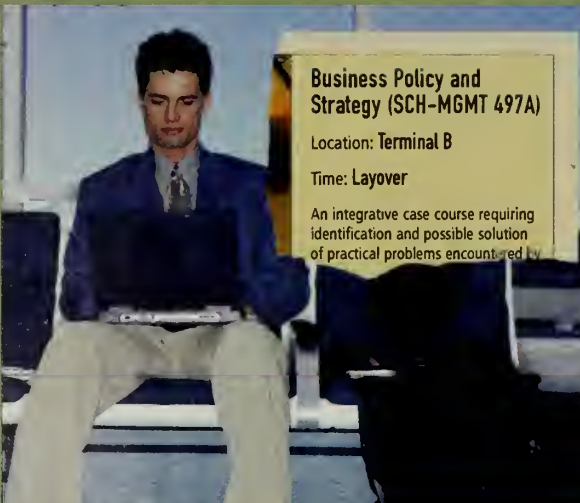
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# Luring Luxury Brands To the Web

Style.com is helping high fashion's icons move online without moving downscale

BY ELIZABETH WOYKE

**T**HE TYPICAL FENDI AD is beautifully styled and impeccably shot, but totally static—models totting \$2,000 handbags are frozen two-dimensionally on glossy pages. That's all changing in late September when Fendi's first video ad goes live on Style.com, the online home of *Vogue* and *W* magazines, just in time for the Italian fashion shows. The video will be peppered across the site, jumping out as a full-screen pop-up and rolling as a 15-second clip before Style.com's videos of the collections.

Fendi is just one of a bevy of luxury-goods retailers, including Valentino Fashion Group and Bottega Veneta, that Style.com has recently lured onto the Web. The six-year-old site attracted 88 advertisers to ply next season's swiny spring dresses online during September's New York Fashion Week, a 54% jump over last year. Designers, who rack up \$14 billion in sales annually, realize they need to follow the changing habits of customers, who increasingly are snapping up the latest must-haves online.

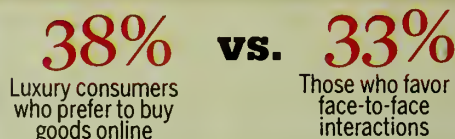
With Style.com, fashion's icons don't just get an association with two of the world's most popular and recognizable fashion magazines. They also can tap an in-house staff that was created specifically to help them design ads, craft online marketing campaigns, and make the digital transition—while remaining glamorous. "We're helping companies that are just getting their toes in the water," says Dee Salomon, Style.com's senior vice-president and managing director.

Luxe fashion houses have been slow to embrace the Internet, even as high-end department stores rushed online. Some offer accessories and beauty products on their sites or put up ready-to-wear. None sell their couture online, though.



## Chasing the Customer

Luxury brands are moving online as customers' habits change\*



\* 19% prefer the phone, 10% answered "other"

Data: Luxury Institute

Rarefied brands, such as Prada and Hermès, traditionally have been family-run and focused on their products, boutiques, and service, says Milton Pedraza, CEO of the Luxury Institute, a New York research group. "They saw the Web as a trade-off instead of an enhancement," he says. Magazines have long been their pre-

ferred advertising venue for a few sir reasons, says Kate Sayre, vice-president of Boston Consulting Group: "They're look beautiful, and you feel like you're getting the right demographics."

Style.com's Salomon, who previously worked for Anne Klein and Donna Karan, recognized this reluctance early on. To appeal to brands that spend up to \$400,000 to shoot magazine ads, the site starts by repurposing the photos so they appear as if luring online as in print. But it quickly moves beyond that, crafting interactive "events" that evoke magazines' glamour.

## GRAND SCALE

TO CELEBRATE the 30th anniversary of Manolo Blahnik, Style.com crafted a stand-alone site that pulled together sketches of famous footwear created by the designer. MAC Cosmetics was so taken with an animated version which bathes Style.com's page in bright pink before scrawling "Glam" (its popular lipstick) across the screen, that MAC copied the look for its own site. "Charles is not spending money on Yahoo for a reason," notes Salomon. "This industry expects things to be done on a grand scale."

Luxury brands are taking bait. "With magazines, I don't know if I'm better off running four pages in publication A or one page in publication B. This calls for a more fine-tuned approach," says Alexander Bolen, CEO of Oscar de la Renta. Others are launching sites and want to funnel traffic their way. Michael Kors Inc. says online sales have exceeded expectations since it began advertising on Style.com in August.

The ad push is critical to Style.com. Revenues are up 50% year-to-date compared with last year. But its status as the Web's fashion destination is being challenged by the likes of *New York Magazine*.

Style.com has shown that banner ads can be elegant. Now it needs to convince luxury brands it's as important to be on the site as in the pages of *Vogue*. ■

**BusinessWeek online** For a podcast about Style.com, go to [businessweek.com/go/06websmart](http://businessweek.com/go/06websmart)

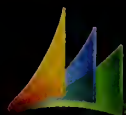
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**URBAN HAVENS** The lobby of Hotel Giraffe in New York (above) and Hotel Commonwealth in Boston (right)



# Small Hotels, Big Personalities

Indie establishments serve up singular style (pillow menu anyone?) along with luxurious touches and 21st century amenities. **BY ANDREW BLUM**

**I** ONCE STAYED AT AN UNASSUMING little hotel in Paris tucked in an alleyway near the Seine. The rooms were decorated with playful mosaics, the hallways smelled of lavender, and in the mornings the manager himself served croissants and jam in the living room. I've been in enough Hampton Inns, Hyatts, and Sheratons since to pine for that place—or, at least, a hotel with similar character.

Turns out such hotels are getting easier to find, even without a passport. On several business trips around the U.S. recently, I've discovered, via a quick online search, some gems hidden in plain sight. They are islands of individuality in a homogenized world, featuring everything from the works of local artists (Hotel Max, Seattle)

and complimentary yoga classes (Vitale, San Francisco) to on-call Pilates workouts and a London-style taxicab shuttles guests to tourist attraction business meetings (Hotel Ambrose, Monica). Yet unlike many family-oriented inns, they also offer 21st century amenities that business travelers want, such as Wi-Fi access (complimentary if you're lucky), cordless phones, flat-screen TVs, and gourmet restaurants. The ICON in Houston, located in an historic bank building, features Bank Georges, created by renowned chef Georges Vongerichten.





**EYE CANDY** (From left) A room at Seattle's Hotel Max, a terrace at the Ambrose Hotel in Santa Monica, and the entrance to Hotel Lucia in Portland, Ore.

t their best, they feel like the hospital-equivalent of the local farmers' market, connected to their communities and loved to run, and the decor is not at all nose-bleed (unlike all those chintz-spread-and-poster B&Bs channeling Queen Victoria). They're not really boutique hotels in the manner of Starwood's W brand or Hilton Hotels, with their emphasis on a hopping lobby scene. Boutique doesn't necessarily mean unique anywhere. And it definitely doesn't mean small, with some boutique properties boasting hundreds of rooms and convention-size public spaces.

## SOFT BRAND

LEAD, CALL THEM indie hotels, hip places, unfettered by any rules, that make you feel like you're somewhere, not lost in a maze of endless corridors and repeating doors. The indies, which tend to have fewer than 100 rooms, don't treat amenities as a checklist to fulfill but rather as a chance to show off their personalities. "In the world of brand differentiation, the idea that something stands out and feels authentic and indigenous is really appealing," says Chip Conley,

chief executive of San Francisco-based Joie de Vivre Hospitality, a "soft brand" that owns the Vitale overlooking the Bay Bridge and 33 other hotels in California, each with its own name and carefully cultivated identity.

Another defining feature of indie hotels: They draw a large part of their clientele from Internet word of mouth. The people who seek out these places often turn to travel review sites such as tripad-

visor.com and citysearch.com, where the global village of online know-it-alls is always ready to flag a flaky concierge, poo-poo poor service, or gush over funky decor. Some 20% of Joie de Vivre's revenues come directly from bookings made via its Web site, which includes a short "matchmaker test" to help you choose a hotel in the chain that suits you. ("What kind of people do you most connect with? Fun-loving and energetic, serene and

## Where To Stay...

**Ambrose Hotel, Santa Monica**  
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Cultivates a homey, Asian-inspired vibe. \$189-\$245

**Hotel Commonwealth, Boston**  
hotelcommonwealth.com  
617 933-5000

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**Hotel Giraffe, New York**  
hotelgiraffe.com 212 685-7700  
Small, stylish, and friendly in Manhattan with Art Deco-style rooms. \$339-\$625

**Hotel ICON, Houston**  
hotelicon.com 713 224-ICON  
Located in the landmark Union National Bank building with a Jean-Georges Vongerichten restaurant. \$179-\$350

**Hotel Lucia, Portland, Ore.**  
hotellucia.com 503 225-1717  
Contemporary design and Thai food room service capture Portland's independent spirit. \$169-\$255

**Hotel Max, Seattle**  
hotelmaxseattle.com  
206 728-6299  
Full of artwork by Seattle artists and quirky amenities. \$179-\$239

**Hotel Preston, Nashville**  
hotelpreston.com 615 361-5900  
An airport hotel with spunk, it's pet-friendly, too. \$109-\$159

**Hotel San Jose, Austin**  
sanjosehotel.com 512 444-7322  
A 1930s motel reimagined as a funky hangout for the local music industry, with lush gardens and vintage chairs. \$90-\$315

**Hotel Vitale, San Francisco**  
hotelvitalerom 415 276-3700  
Ideally situated across from the Fisherman's market at the Ferry Building. \$279-\$399





## ROOM WITH A VIEW

Hotel Vitale in San Francisco (above and above left), one of 33 in the Joie de Vivre chain, offers vistas of the Bay Bridge. The Icon Hotel in Houston (left) boasts a Jean-Georges Vongerichten restaurant and unusual touches, such as brass door knockers

rooms. Each guest-room door was adorned with a unique photograph, which came in handy at the end of a long day when I reversed the room number and ended up on the wrong floor. (I know that picture didn't look familiar....mine was a close-up of a woman's lips.) All this plus a good bed, flat-screen TV, and \$11.95 a day wireless Internet

soulful....") As often as not, its guests are on business trips: Joie de Vivre reports a fifty-fifty split between business and leisure travelers.

TripAdvisor led me to the Hotel Max when I was planning a short visit to Seattle this summer. After typing in "Seattle hotels," I scrolled down past the W, Grand Hyatt, and Best Western before the Max popped up. When I saw it there, it seemed too good to be true: a stylish-looking place with plenty of amenities, located right in Seattle's downtown, for barely \$200 a night. The reviews, while overwhelmingly positive, revealed the catch: tiny rooms. But that was an acceptable trade-off for me, since I'd be traveling alone and, anyway, I'm accustomed to the tight confines of many New York City living spaces. I knew I couldn't count on frequent guest points, but in a way that was the idea: I wanted a unique experience, not a standardized one that

might someday earn me another standardized one. And I liked the stylishness, simplicity, and straightforwardness of the hotel's Web site.

After checking Google Maps to see if the hotel was close to where I needed to be in Seattle, I took one final step before booking it: I hit Google's "Satellite" button for a spaceship-eye view. You can tell a lot from an aerial photograph: Is the hotel on an urban thoroughfare or a suburban street? Is it surrounded by parking lots or parks? Is there a construction site across the street? This step may not be necessary if you're looking at the Hyatt or Sheraton, whose names alone typically convey something about their location, condition, and safety. But in the comparative wilds of indie hotels, a few extra clicks can't hurt.

## LOST LIPS

THE MAX DIDN'T disappoint. It felt like Seattle, right down to the quirky touches (such as a menu of pillow choices) and original paintings by Seattle artists in the public spaces and on the walls of the

access that worked, and room-service breakfast that arrived right on time.

The moment that clinched it—sold me on the advantages of ducking brands—came while checking in. Knowing I wouldn't be heading to the port until late that night, I inquired whether my 24-hour pass for Internet access would work throughout the day, the reception clerk said. But then the man stage-whispered the password to the lobby's wireless network, and we giggled. Problem solved.

When I related the experience to Howard Jacobs, chief operating officer of Aspen Hotel Group in Portland, which owns the Max, he said the gesture wasn't as spontaneous as it might seem. No, the Max doesn't have a policy of revealing passwords. But it makes sure the staff is empowered, on all levels. "They have a broad range of autonomy," Jacobs says. As do business travelers choosing hotels. ■

**BusinessWeek online** For a slide show of indie hotels, go to [businessweek.com/ex](http://businessweek.com/ex)



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# It's Your Neck



● **SATIN FINISH** The sheen of the thin gold and rose-colored stripes dresses up this \$165 textured woven tie from Charvet. Wear it with a tux or business suit.

● **CLASSIC** This printed silk orange number with a blue link pattern is a bright accent for fall. It's \$149 from French design house Hermès.



● **NOVELTY** Psycho Bunny is a new \$110 variation of the popular skull and-crossbones apparel theme.

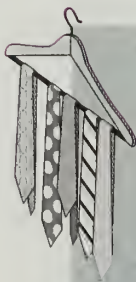
● **PRINT** Birds get more subtle in this \$100 tie from London clothier Thomas Pink.

● **PAISLEY** Isaia's \$195 reinterpretation of the familiar pattern is more muted than the colorful paisleys of yore.

\* The Charvet, Hermès, and Isaia ties are available at fine retailers. Psycho Bunny will be sold exclusively in select Neiman Marcus stores by Oct. 1. Thomas Pink stores carry that brand.

What can you expect in neckwear this fall? These five ties wrap up the season in one neat half-Windsor

**BY GREG HAFKIN**



## Tips for Tie Care

**HANG UP THE TIE** to take out wrinkles, but make sure to unknit it first.

**NEVER APPLY WATER** to a silk tie. This could make a small stain even bigger and shrink the lining.

**DON'T TRY TO RUB** out greasy stains. You could wear out the color.

**DON'T IRON THE TIE.** It will ruin the rolled edges and make it look like a pancake.

**ROLL THE TIE** or carry it in a case when traveling, and hang

it up as soon as you get to your destination.

**FOR TIE EMERGENCIES** Contact a high-end tailor or dry clean for stain removal, alterations, or repairs. On the Web go to [tiecrafters.com](http://tiecrafters.com)

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BY ROBERT PARKER

# The Fruits of A Good Education

Vintner David Ramey trained under Christian Moueix, winemaker at Bordeaux's Château Pétrus, both in France and at Moueix's Napa operation, Dominus Estate. Then, 10 years ago, Ramey set up Ramey Winery Cellars in Healdsburg in Sonoma County. Without vineyards of his own right now, Ramey buys grapes from growers he has known for years. Here are some of his current and upcoming releases.

## 2003 Chardonnay Russian River

**92 points.** The substantial, heady, intense chardonnay comes primarily from an impeccable source, the Charles Heintz Vineyard near Occidental, Calif. Its 20-year-old vines provide minerality, lemon oil, brioche, and tropical fruit characteristics as well as substantial intensity and richness. Drink it over the next two to three years. \$36

## 2003 Chardonnay Sonoma Coast

**90 points.** The stunning white is a 700-case blend offering notes of tropical fruits, lemon oil, and crushed rocks. Layered, rich, full-bodied, it is one of my favorites of Ramey's appellation chardonnays. \$36

## 2003 Chardonnay Hyde Vineyard

**94 points.** A dazzling wine of great individuality, with wonderful minerality, sweet lemon oil, honeysuckle, white currant, and floral notes intermixed with a crushed rock-like note and a long, heady, full-bodied finish. This beautiful, pure chardonnay should age nicely for five to seven years. \$56

## 2003 Chardonnay Ritchie Vineyard

**95 points.** Fashioned from a vineyard planted in 1972, this wine shows opulent levels of tropical fruit intermixed with beeswax and orange skin/nectarine notes. It is full bodied, with superb purity, terrific acidity, and a long, heady finish. \$56

## 2004 Jericho Canyon Vineyard Cabernet Sauvignon

**93 points.** A blend of 76% cabernet sauvignon,



22% merlot, and 2% cabernet franc, it exhibits a deep purple color and a sweet nose of jammy black fruit intermixed with smoke, licorice, and incense. The wine is ripe, opulent, fleshy, and up front, as so many 2004s tend to be. This full-bodied, velvety-textured effort should drink well for 15 or more years. \$75

## 2003 Jericho Canyon Vineyard Napa Valley

**93 points.** From a 40-acre parcel at the base of Mount St. Helena, this blend of 87% cabernet sauvignon, 10% merlot, and 3% cabernet franc represents Ramey's homage to Bordeaux's Pauillac. With a big sweet nose of white chocolate, crème de cassis, cedar, spice box, and high-quality smoky oak, it is full bodied,

rich, and tannic with notes of chocolate espresso in the mouth. It needs several years of cellaring and should last 15 to 20 years. \$95

## 2004 Larkme Vineyard Cabernet Sauvignon

**92 points.** This 1 case blend (78% cabernet sauvignon, 13% petite verdot, 9% malbec), is a special example of just this Napa Valley site is. Its

ruby/purple color is followed by aromas of graphite, licorice, flowers, and black currant in addition to some minerality. This medium full-bodied, noble, complex red should be from one to two years of cellaring and drinking for 10 to 12 years. \$95

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EDITED BY MONICA GAGNIER

## TIME OFF

### A GLIMPSE OF SIKH ART IN NEW YORK

**MANY PEOPLE** can identify members of the Sikh religion by their distinctive headress. But they may know little about Sikh culture and beliefs. The Rubin Museum of Art (RMA) in New York is shedding light on the world's fifth-largest religion with a new exhibit, *I See No Stranger: Early Sikh Art and Devotion*, that runs from Sept. 18 to Jan.



29. The show of 100 works from the 16th to 19th centuries includes paintings, drawings, textiles, and metalwork exploring the religion, which preaches that people of different races, religions, and gender are equal. Many of the

works will be on view for the first time in the U.S. at the Rubin, which opened in 2004 and is dedicated to the arts of the Himalayas ([rmanyc.org](http://rmanyc.org)). In addition to its building at 17th Street and Seventh Avenue in Manhattan, RMA maintains an interactive Web site, [exploreart.org](http://exploreart.org).



## CITIES

### The Tucson Trail

**YOU'VE HEARD OF** Boston's Freedom Trail. But did you know Tucson has a similar self-guided walking tour of historic sites? The Presidio Trail went way for 2½ miles through downtown. Just follow the turquoise stripe.

The trail starts at the site of Presidio San Agustín de Tucson, where the fort was founded in 1775. The Spanish garrison is long gone, but a portion of the fort is being reconstructed for a cultural heritage park set to open next year.

The tour takes in some striking architecture. Two high spots: the Pima County Courthouse (1929), a majestic Spanish Colonial Revival building with a blue-tile dome and an impressive interior courtyard, and the newly restored Teatro Carmen (1929), a rare Southwestern Art Deco structure. Other notable sites include the Teatro Carmen, built in 1915 as a home for Spanish-language theater, and the well-preserved, and still thriving, Hotel Congress (1919), where local authorities nabbed bank robber John Dillinger and his gang in 1934.

Get a map at the Convention & Visitors Bureau, 100 S. Church Ave., or [tucsonpresidiotrust.org](http://tucsonpresidiotrust.org). Leave your spurs at home.

—Doug F.

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Cardways tucks it inside a greeting card—you can personalize that, too—and mails it to the recipient. Shipping costs you only the price of a first-class stamp. —Larry Armstrong



## ELECTRONICS

### THE IPOD'S WET SUIT

**WHETHER YOU'RE SWIMMING** or just want to protect your iPod from the elements, here's the best way. Otter (otterbox.com) makes a waterproof, shock-resistant housing for every iPod model. Prices range from \$20 to \$50. What sets the OtterBox apart from other makers' rugged cases is the flexible membrane over the iPod's click wheel: It allows you to control your music through the case.

—Larry Arm



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**UP AT OXFORD** Des the high exchange rate, Schuller will spend far less for degree than he w have at a similar school in the U.S.

# Who Needs Harvard or Yale?

U.S. students are discovering the advantages of elite British universities. **BY MARK SCOTT**

**I**F YOU'RE INTO PRESTIGE AS well as a top-notch education, Oxford is right up there with Harvard. Yet consider this: An incoming freshman at Harvard College is looking at an estimated \$185,800 for tuition and room and board over the next four years. The same student can earn a degree at Oxford in just three years for about \$112,000—and that includes all school expenses, plus travel to and from the States.

The Oxford deal was too good to pass up for Christopher Schuller, a 20-year-old Nashville native who is starting his third year there with a double major in law and

German law. "Even with overseas fees and the high exchange rate, Oxford is still cheaper," says Schuller, who found a similar cost advantage in the British school over his top stateside pick, the University of Chicago.

Who needs the Ivies, or any other elite U.S. college, when your kid can hop across the Atlantic for an excellent educational adventure? Besides lower costs (table), prestigious British universities offer the excitement of living abroad. Plus, they have less stringent entry requirements than Ivy League schools. For example, the University of St. Andrews, Scotland's top-ranked university, ex-

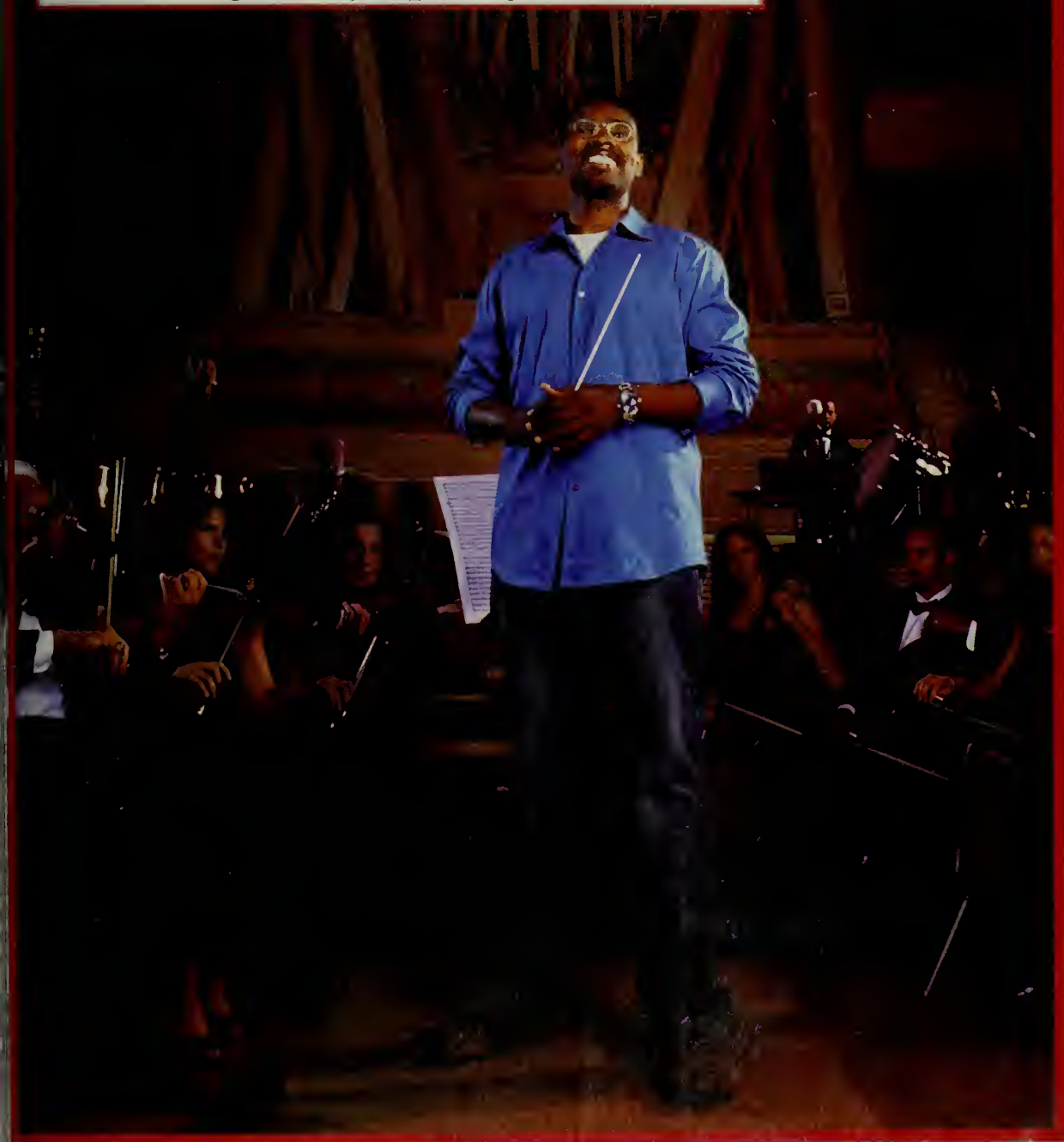
pects applicants to have SAT scores around 1,300, compared with 1,500 for most Ivies. The London School of Economics and Political Science doesn't even use the SAT, instead requiring four advanced placement (AP) courses with scores of 4 or 5.

More U.S. students are noticing these advantages. According to Britain's Universities & Colleges Admissions Service (UCAS), 2,201 U.S. high school students applied to full-time undergrad programs at British universities last year, a 40% increase since 1996. Some 948 were accepted. "Students get the chance to experience a different culture while getting a top-of-the-line academic experience," says Marsha Little, director of international counseling at the Lovett School, a private school in Atlanta.

## COMPETITIVE EDGE

A DEGREE FROM a top British university can also offer that extra edge in an increasingly competitive and global market. Alex Dresner, a 20-year-old sophomore at the LSE from Washington, D.C., believes the experience he's gained while studying overseas helped him land an internship at a communications consulting firm this summer. Harris, adviser at the LSE career service,

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thinks the school's pedigree plays well with employers. "We have a pretty good reputation with Goldman Sachs and Morgan Stanley, as well as the White House and the Pentagon," he says.

The British approach to higher education may not appeal to everyone. Unlike the broad liberal arts curriculum offered by U.S. schools, British universities require students to specialize from their freshman year. For example, a biology major would take only classes related to the degree, and it would be difficult to branch out. Switching majors, in effect, is starting over.

## A DIFFERENT WORLD

THE CHANCE TO specialize at such an early stage can be a bonus in many professions. When Schuller finishes his degree at Oxford, he will be able to qualify to take the New York State Bar exam upon completing a U.S. law refresher course. That will save him tens of thousands of dollars on the cost of law school, plus he'll have the opportunity to earn money during the three years he would have been in school.

Even though Britain and the U.S. share a language, Americans studying in Britain have to adjust to a different culture, a task harder than it might seem.

Class hours, for example, are kept to a minimum, typically less than 10 per week, with students splitting their time between small seminars and larger lectures. Independent study is the name of the game; there is typically no set homework, and students must motivate themselves rather than rely on professors. Most schools start in late September or early October, and run over two or three semesters until mid-June. "American students struggle in the first term with the different type of learning," says Tao Tao Chang, head of Cambridge's international office, who adds that most go on to thrive at the university.

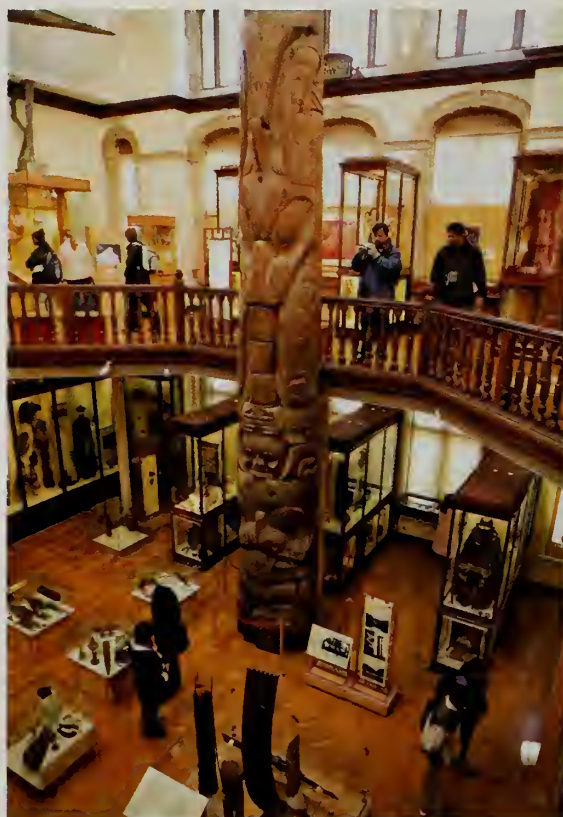
Social life also differs from U.S. schools. With no fraternities, sororities, or large-scale college sports, extracurricu-

lar life revolves around student unions: campus-based organizations that run everything from school elections to parties and help students with academic and personal problems. Societies, or student clubs, also play a part. There's usually something for everyone, ranging from sports and charity organizations to drama and political groups.

The application process will be foreign to U.S. students. They apply through UCAS ([ucas.ac.uk](http://ucas.ac.uk)), not directly to the schools. (The one exception is St. Andrews, which offers a special form similar

## HIGHER LEARNING

Last year 2,201 U.S. high school students applied to British colleges, such as Cambridge (top) and St. Andrews (above)



to those for U.S. colleges.) Early in the application becomes available and includes a personal statement and one teacher reference. You can apply to six universities in total for a flat fee of \$30. The deadline for Oxford and Cambridge is Oct. 15 because both require an in-person interview. For any other schools, the deadline is June 30, with most schools sending out acceptance letters by mid-August. British schools have little scholarship money available, so most U.S. students must pay their own way. Those in need of aid can apply to Sallie Mae International for student loans, just as if they were going to a U.S. school (salliemae.com; 877 456-6221).

## What it costs..

These elite British colleges look like bargains compared with Ivy League schools such as Harvard, where tuition is \$30,275 a year

**Imperial College London**  
[imperial.ac.uk](http://imperial.ac.uk) Tuition \$26,000

**London School of Economics**  
[lse.ac.uk](http://lse.ac.uk) Tuition \$22,000

**University of Cambridge**  
[cam.ac.uk](http://cam.ac.uk) Tuition \$23,000

**University of Edinburgh**  
[ed.ac.uk](http://ed.ac.uk) Tuition \$22,000 (Humanities/Social Sciences) \$26,000 (Science/Engineering)

**University of Oxford**  
[ox.ac.uk](http://ox.ac.uk) Tuition \$27,000

**University of St. Andrews**  
[st-andrews.ac.uk](http://st-andrews.ac.uk) Tuition \$20,000

\*Humanities/Social Sciences \*\*Science/Engineering  
Data: Britain's Universities & Colleges Admissions Service

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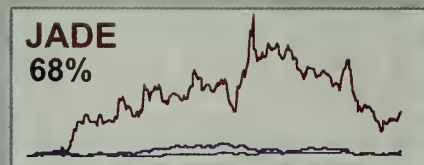
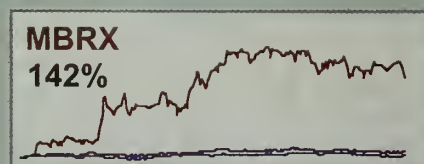
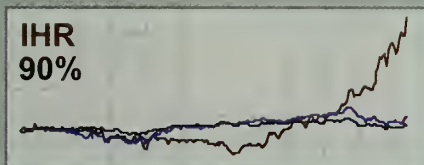
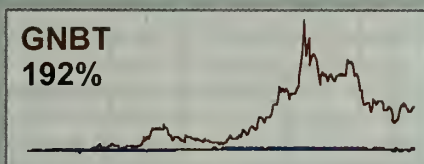
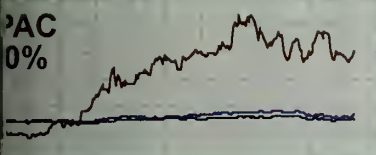
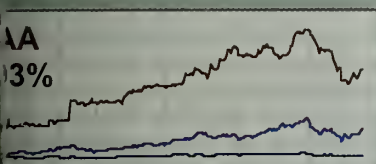
When it comes to bang for your buck, going abroad for college can be a great idea. But will a degree from a British university help American students when they go home? For Zahra Nawaz, a 22-year-old LSE graduate from Alexandria, Va., it definitely has. After returning to the U.S. in 2004, she was accepted into the master's program in security studies at Georgetown University and began working part-time at the Homeland Security Institute, a think tank of the U.S. Department of Homeland Security. Nawaz has some advice for any student thinking about taking the British route. "Be open, consider everything, and don't be afraid to get out of your comfort zone," she says. "In the end, the different cultural experience you'll get is an education in itself." ■



# 6 TOP COMPANIES: AVERAGE 134% RETURN

## Equity Investor's Micro-Cap Review

Micro-Cap companies featured on this page were among America's top domestically traded companies by market capitalizations from \$20 million to \$500 million, in terms of 12-month share price performance for the period ending 6/30/06. While past performance is never a guarantee of future results, these six companies present investment opportunities worthy of any Micro-Cap investor's close consideration.



12 Month Price Performance for period ending 06/30/06

● Stock

● Industry

● SP500

### Banro Corporation

Symbol: BAA

Industry: Mines & Metals

Contact: Martin Jones

m.jones@banro.com

Banro is fast-tracking exploration and development of its 4 wholly-owned gold projects in the Democratic Republic of Congo. Led by proven management and financed by the chip funds in the US and abroad, Banro is at the forefront of one of the world's most exciting and last remaining mining frontiers.

CAPITALIZATION: \$377 mil.

GOLD RESOURCES:

[www.banro.com/s/Resources.asp](http://www.banro.com/s/Resources.asp)

FINANCINGS DURING PERIOD: \$79 MM

2006 EXPLORATION BUDGET: \$19 MM

CASH ON HAND: \$63 MM

### APAC Customer Services, Inc.

Symbol: APAC

Industry: Outsourcing Services

Contact: George H. Hepburn, III, CFO

ghepburn@apacmail.com

APAC is a leading provider of customer service solutions and solutions for market leaders in healthcare, financial services, business services, publishing and travel industries. A strategic realignment in 2005 led to exiting outbound acquisition business and aggressively expanding offshore operations, automatically improving margins and profitability.

CAPITALIZATION: \$95.2 mil.

HEALTHCARE SOLUTIONS: Inc. 187% Q2 '06

MARKET PRICE/SALES RATIO: 0.4x

Q2 2006 GROSS PROFIT MARGIN: 12.5%

Q2 2005 GROSS PROFIT MARGIN: 4.9%

### Generex Biotechnology Corp.

Symbol: GNBT

Industry: Healthcare/Drug Delivery

IR Contact: In-house 1-800-391-6755

[www.generex.com](http://www.generex.com)

Generex Biotechnology Corp. is engaged in the research, development, and commercialization of proprietary drug delivery systems and technologies in the areas of metabolic diseases and immunotherapeutics (Avian Flu Influenza). The core proprietary platform technologies include the company's flagship product Generex Oral-lyn™ and its companion product Glucose RapidSpray™.

• CAPITALIZATION: \$145 mil.

• AVG VOL (3M): 3,428,900

• 52WK RANGE: 0.53 - 5.02

• EPS (ttm): -1.04

### Interstate Hotels & Resorts, Inc.

Symbol: IHR

Industry: Lodging & Leisure

IR Contact: Carrie S. McIntyre

carrie.mcintyre@ihrc.com

Interstate Hotels & Resorts, Inc. is the nation's largest independent hotel management company, operating more than 250 hospitality properties with 59,000 rooms. The company has ownership interests in 26 properties, either within joint ventures or wholly owned. Its subsidiary, BridgeStreet Worldwide, Inc. is one of the world's largest corporate housing providers.

• CAPITALIZATION: \$290 mil.

• STOCK PERFORMANCE: 90%

• 2005 REVENUE: \$1.1B

• PRICE / EARNINGS TTM: 17.5

• PRICE / CASHFLOW TTM: 8.74

### Metabasis Therapeutics, Inc.

Symbol: MBRX

Industry: Biotechnology

IR Contact: Constance Bienfait

bienfait@mbasis.com

Metabasis Therapeutics, Inc. is a biopharmaceutical company focused on the discovery, development and commercialization of novel therapies to address metabolic diseases involving pathways to the liver, such as diabetes and hyperlipidemia, as well as liver diseases such as hepatitis and liver cancer.

• CAPITALIZATION: \$194.3 mil.

• TOTAL DEBT/EQUITY RATIO: .05

• PRICE/BOOK RATIO: 1.9

• CASH TTM: 3.2

• ENTERPRISE VALUE: \$96.7 million

### LJ International, Inc.

Symbol: JADE (Nasdaq)

Industry: Consumer Durables

IR Contact: Haris Tajyar

htajyar@irintl.com

China-based LJ Intl. has grown by over 20% for the past three years selling to both the U.S. and now China. Its ENZO Division, which has grown to become the largest foreign jewelry chain in China in less than two years, is expected to accelerate LJ's future growth.

• CAPITALIZATION: \$76.05 mil.

• 12-MO REVENUE GROWTH: \$101.33 mil

• 12-MO. EPS: \$0.23

• P/E RATIO (ttm): 15x-19x Earnings

• REV. & EBITDA CAGR: 20%+ (3-5 year avg.)





BY GENE G. MARCIAL

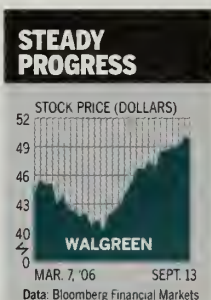
**WALGREEN** DRUGSTORES ARE SUPER RELIABLE—FOR GROWTH.

WILL A MEDICAID FRAUD PROBE PUT **OMNICARE** ON THE SICK L

**THE KNOT** IS A TOP WEB STOP-OFF ON THE WAY TO THE ALTAR.

## Green-Lighting Walgreen

**W**HEN THE MARKET GETS CHOPPY, go for the proven long-haul winners. So counsels Michael Schwartzman, president of ValueSearch Capital Management, who singles out Walgreen (WAG), the No. 1 U.S. drugstore chain, as a prime example. Walgreen, in which ValueSearch owns shares, is “well managed, with a conservative approach to accounting,” and has avoided sorry surprises and earnings restatements, Schwartzman says. Since May its stock has shot from 39 to 49.31. In four years he sees it at 93 based on his earnings growth forecast. Walgreen operates 5,200 stores in 45 states and Puerto Rico. It was featured here on July 10, 2001, when it was at 29. Schwartzman is confident about the predictability of its earnings because they are driven by organic growth, not high-priced acquisitions that usually bring heavy debt. Walgreen’s few buys, he notes, have been small independent chains that lacked the resources to battle with big rivals. Walgreen’s prescription and non-pharmacy sales growth in 2005 beat those of the industry, notes Standard & Poor’s, which rates it a “buy.” Neil Currie of UBS, who also pegs Walgreen as a “buy,” forecasts above-consensus earnings of \$1.74 a share on sales of \$46.9 billion for fiscal 2006 ended Aug. 31. He says: “Walgreen deserves to be a core long-term holding.” For 2007, Currie sees earnings of \$2.01 on sales of \$53 billion. Last year, Walgreen earned \$1.54 on \$42.2 billion. Currie’s 12-month price target: 60.



## Omniconfident About Omnicare

**O**MNICARE (OCR), A LEADER in pharmacy services for health-care providers, has taken a shellacking since March. Shares plummeted from 60 to 44.16 following Omnicare’s earlier disclosure of a probe into allegations of Medicaid fraud against the head of its Michigan unit. But most of the 14 analysts who track the stock remain bullish. John Maloney, president of M&R Capital Management, says Omnicare is the “dominant franchise in U.S. institutional pharmacies, and the case won’t alter the fundamentals of its business.” He has upped his holding and has a 12-month price target of 60. On Aug. 16, Michigan Attorney General Mike Cox

filed 149 counts of Medicaid fraud against the head of Omnicare’s Specialized Pharmacy Services, involving \$5 million in alleged faked billings. Omnicare has set up a \$53 million reserve for costs relating to the probe and says it is continuing talks with Cox. Lisa Gill of JPMorgan Securities, which has done business with Omnicare, rates it “overweight.” She says its “competitive advantage, size, and scale should lead to continued market-share gains.” She foresees earnings of \$2.98 in 2006 and \$3.6 2007, vs. \$2.48 last year.



## The Knot and WeddingChannel Just Married

**W**EDDINGS ARE A \$72 billion-a-year business, a The Knot (KNOT) is a major player. Already, its site is the biggest destination for bridal shopping gift registry services, with 4 million monthly unique visits. In August The Knot widened its online presence by acquiring WeddingChannel.com, the leading online bridal registry. Knot also publishes several magazines devoted to weddings. Its stock has run up this year from 11 to 20. The Knot was featured in this column on Apr. 11, 2005, when it was at 7.20. Jeetil Patel of Deutsche Bank rates The Knot a “buy” because it offers investors exposure to the rise in online ads, which last year captured 10% of the \$1.5 billion spent on wedding ads. He figures the purchase will add \$29 million to sales and \$14 million to earnings before interest, taxes, depreciation, and amortization (EBITDA) in 2007. On a pro forma basis, P sees earnings of 44¢ a share on sales of \$71 million in 2006 and 77¢ on \$108 million in 2007. Richard Fetyko of Meri Curhan Ford, who also rates The Knot a “buy,” has raised 2007 forecast from 70¢ a share to 78¢. ■



**BusinessWeek online** Gene Marcial’s Inside Wall Street is posted at [businessweek.com/investor](http://businessweek.com/investor) at 5 p.m. EST on the magazine’s publication day, usually Thursdays.

**Note:** Unless otherwise noted, neither the sources cited in Inside Wall Street nor the author hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.





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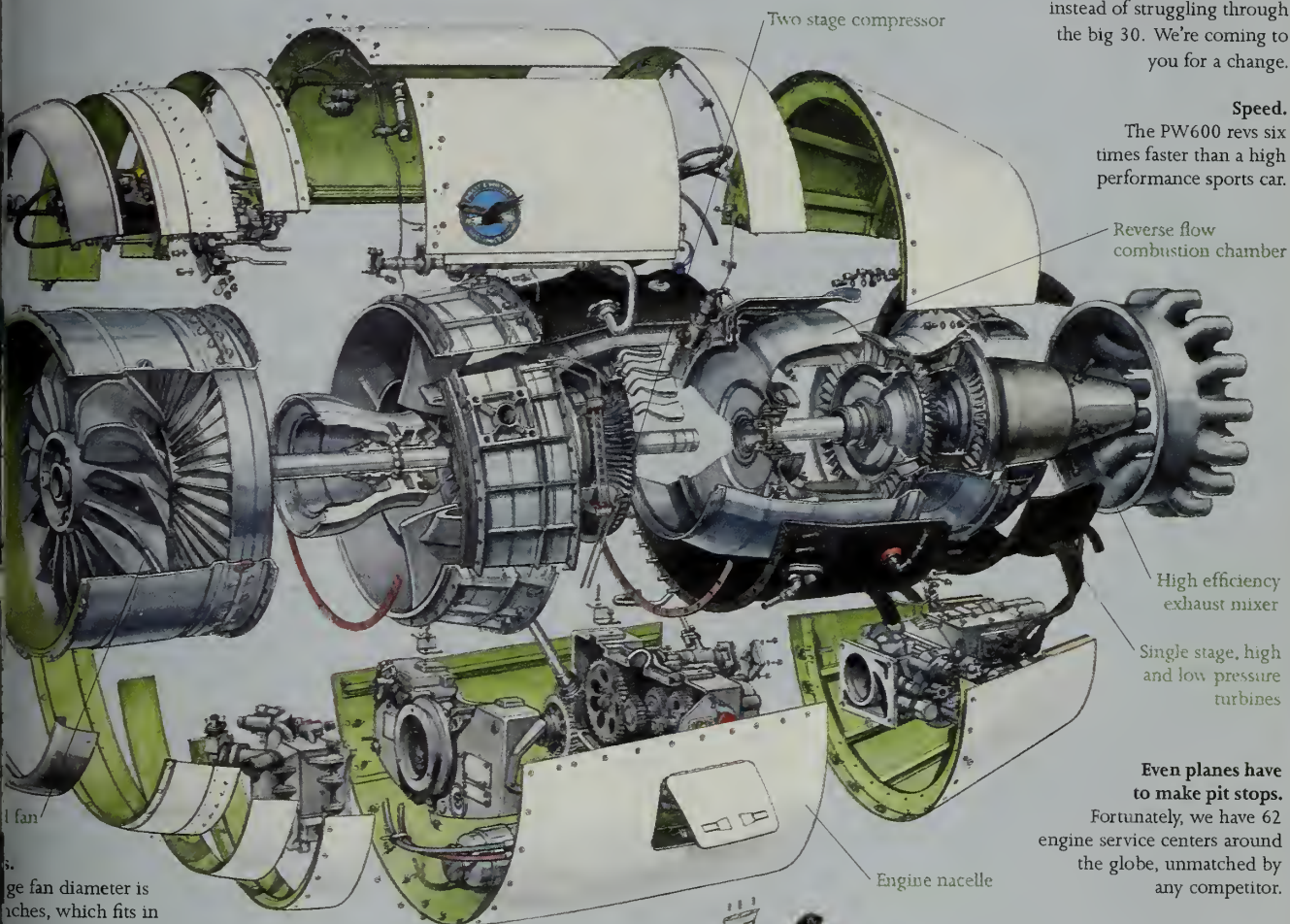
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**United  
Technologies**

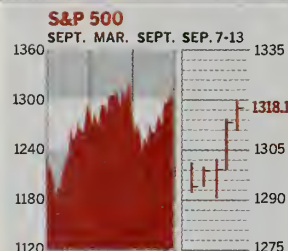
You can see everything from here.

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performance provides no assurance of future performance. Future performance may vary materially from prior periods due to a number of risk factors including those described in UTC's 10-K, 10-Q and 8-K  
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## STOCKS



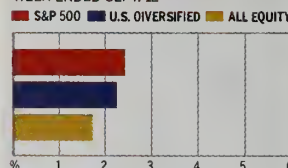
### COMMENTARY

Plunging oil prices, healthy profits from Wall Street firms such as Goldman Sachs, and upgrades in the tech sector fueled a four-day stock market rally that brought the Dow Jones Industrial Average to within 200 points of its January, 2000, all-time high of 11,722.98. Tamping down the enthusiasm, as always, were housing and consumer spending worries.

Data: Bloomberg Financial Markets, Reuters

## MUTUAL FUNDS

### 4-WEEK TOTAL RETURN



### 52-WEEK TOTAL RETURN



Data: Standard & Poor's

## U.S. MARKETS

|                       | SEPT. 13 | WEEK | % CHANGE YEAR TO DATE | LAST 12 MONTHS |
|-----------------------|----------|------|-----------------------|----------------|
| S&P 500               | 1318.1   | 1.4  | 5.6                   | 7.1            |
| Dow Jones Industrials | 11,543.3 | 1.2  | 7.7                   | 8.9            |
| NASDAQ Composite      | 2227.7   | 2.8  | 1.0                   | 2.6            |
| S&P MidCap 400        | 757.4    | 1.9  | 2.6                   | 5.8            |
| S&P SmallCap 600      | 374.8    | 2.6  | 6.9                   | 6.9            |
| DJ Wilshire 5000      | 13,186.8 | 1.4  | 5.5                   | 7.1            |

## SECTORS

|                      |       |      | % CHANGE YEAR TO DATE | LAST 12 MONTHS |
|----------------------|-------|------|-----------------------|----------------|
| BusinessWeek 50*     | 743.1 | 1.9  | 0.2                   | 0.1            |
| BW Info Tech 100**   | 397.4 | 1.9  | 4.5                   | 7.4            |
| S&P/Citigroup Growth | 612.5 | 1.5  | 2.7                   | 4.0            |
| S&P/Citigroup Value  | 703.4 | 1.2  | 8.6                   | 10.3           |
| S&P Energy           | 403.2 | -3.9 | 8.2                   | 4.1            |
| S&P Financials       | 456.8 | 1.9  | 7.1                   | 14.8           |
| S&P REIT             | 184.4 | 2.1  | 20.5                  | 19.2           |
| S&P Transportation   | 253.3 | 4.7  | 1.4                   | 19.6           |
| S&P Utilities        | 171.9 | -0.6 | 7.7                   | 2.9            |
| GSTI Internet        | 174.4 | 2.1  | -15.0                 | -2.2           |
| PSE Technology       | 819.2 | 2.6  | -2.1                  | -0.9           |

\*Mar. 19, 1999=1000 \*\*Feb. 7, 2000=1000

## GLOBAL MARKETS

|                             | SEPT. 13 | WEEK | % CH. YEAR TO DATE |
|-----------------------------|----------|------|--------------------|
| S&P Euro Plus (U.S. Dollar) | 1751.5   | 0.2  | 15.9               |
| London (FT-SE 100)          | 5892.2   | -0.6 | 4.9                |
| Paris (CAC 40)              | 5137.9   | 0.4  | 9.0                |
| Frankfurt (DAX)             | 5906.1   | 1.6  | 9.2                |
| Tokyo (NIKKEI 225)          | 15,750.1 | -3.3 | -2.2               |
| Hong Kong (Hang Seng)       | 17,210.0 | -0.3 | 15.7               |
| Toronto (S&P/TSX Composite) | 11,777.2 | -1.9 | 4.5                |
| Mexico City (IPC)           | 21,320.2 | 1.7  | 19.8               |

## FUNDAMENTALS

|                                      | SEPT. 12 | WEEK AGO |
|--------------------------------------|----------|----------|
| S&P 500 Dividend Yield               | 1.84%    | 1.84%    |
| S&P 500 P/E Ratio (Trailing 12 mos.) | 17.3     | 17.3     |
| S&P 500 P/E Ratio (Next 12 mos.)*    | 14.4     | 14.3     |
| First Call Earnings Revision*        | -1.42%   | -1.21%   |

\*Firm

## TECHNICAL INDICATORS

|                                       | SEPT. 12 | WEEK AGO |
|---------------------------------------|----------|----------|
| S&P 500 200-day average               | 1278.8   | 1277.6   |
| Stocks above 200-day average          | 55.0%    | 57.0%    |
| Options: Put/call ratio               | 0.93     | 0.86     |
| Insiders: Vickers NYSE Sell/buy ratio | 3.29     | 3.21     |

## BEST-PERFORMING GROUPS

|                    | LAST MONTH % |                          | LAST 12 MONTHS % |
|--------------------|--------------|--------------------------|------------------|
| Tires & Rubber     | 30.8         | Agricultural Products    | 65.1             |
| Internet Retailers | 21.5         | Steel                    | 61.2             |
| Food Wholesalers   | 19.4         | Divsfd. Metals & Mining  | 53.0             |
| Automobiles        | 17.0         | Fertilizers & Ag. Chems. | 40.4             |
| IT Consulting      | 16.6         | Constr. & Engineering    | 32.2             |

## WORST-PERFORMING GROUPS

|                      | LAST MONTH % |                      | LAST 12 MONTHS % |
|----------------------|--------------|----------------------|------------------|
| Oil & Gas Refining   | -18.9        | Educational Services |                  |
| Coal                 | -13.9        | Homebuilding         |                  |
| Oil & Gas Equipment  | -11.9        | Internet Retailers   |                  |
| Gold Mining          | -11.6        | IT Consulting        |                  |
| Integrated Oil & Gas | -8.6         | Wireless Services    |                  |

## EQUITY FUND CATEGORIES

| 4-WEEK TOTAL RETURN | %    | 52-WEEK TOTAL RETURN    | %    |
|---------------------|------|-------------------------|------|
| <b>LEADERS</b>      |      | <b>LEADERS</b>          |      |
| Technology          | 5.8  | Precious Metals         | 46.3 |
| Communications      | 5.0  | Latin America           | 35.5 |
| Real Estate         | 4.5  | Diversified Emrg. Mkts. | 24.5 |
| Health              | 3.1  | Real Estate             | 23.2 |
| <b>LAGGARDS</b>     |      | <b>LAGGARDS</b>         |      |
| Natural Resources   | -7.3 | Health                  | 2.2  |
| Precious Metals     | -4.6 | Technology              | 2.5  |
| Latin America       | -2.3 | Large-cap Growth        | 2.9  |
| Japan               | -1.8 | Small-cap Growth        | 3.2  |

## EQUITY FUNDS

| 4-WEEK TOTAL RETURN            | %     | 52-WEEK TOTAL RETURN       | %     |
|--------------------------------|-------|----------------------------|-------|
| <b>LEADERS</b>                 |       | <b>LEADERS</b>             |       |
| American Heritage              | 14.3  | Midas                      | 74.0  |
| ProFunds Semicdr. Inv.         | 13.0  | U.S. Global Invs. Gold     | 73.1  |
| DireXn. NASDAQ 100 BI 25X Inv. | 12.8  | U.S. Gbl. Invs. Prc. Mnl.  | 67.1  |
| SPDR Semi Cndr. ETF            | 10.5  | Van Eck Invs. Gold A.      | 63.8  |
| <b>LAGGARDS</b>                |       | <b>LAGGARDS</b>            |       |
| ProFunds Prec. Mtls. Inv.      | -13.5 | Ameritor Investment        | -81.8 |
| ProFunds Oil Equip. Inv.       | -13.4 | American Heritage Grth.    | -50.0 |
| ProFunds Oil & Gas Inv.        | -13.0 | ProFds. Mble. Tlcmms. Inv. | -24.4 |
| Rydex Commodities H            | -12.0 | Prasad Growth              | -18.6 |

## INTEREST RATES

### KEY RATES

|                          | SEPT. 13 | WEEK AGO |
|--------------------------|----------|----------|
| Money Market Funds       | 4.84%    | 4.84%    |
| 90-Day Treasury Bills    | 4.90     | 4.96     |
| 2-Year Treasury Notes    | 4.79     | 4.81     |
| 10-Year Treasury Notes   | 4.76     | 4.80     |
| 30-Year Treasury Bonds   | 4.89     | 4.95     |
| 30-Year Fixed Mortgage † | 6.16     | 6.20     |

†BanxQ

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|                       | 10-YR. BOND | 30-YR. BOND |
|-----------------------|-------------|-------------|
| General Obligations   | 3.85%       |             |
| Taxable Equivalent    | 5.50        |             |
| Insured Revenue Bonds | 3.89        |             |
| Taxable Equivalent    | 5.56        |             |

## THE WEEK AHEAD

### CURRENT ACCOUNT Monday,

Sept. 18, 8:30 a.m. EDT » The second-quarter current account deficit is forecast to be \$214.4 billion. That's according to the median forecast of economists surveyed by Action Economics. In the first quarter, the deficit stood at \$208.7 billion.

### PRODUCER PRICE INDEX

Tuesday, Sept. 19, 8:30 a.m. EDT » Producer prices most likely increased 0.2% in August, after a

0.1% gain in July. Even after excluding food and energy, producer prices probably rose by 0.2%, following a 0.3% fall in July.

### RESIDENTIAL CONSTRUCTION

Tuesday, Sept. 19, 8:30 a.m. EDT » August housing starts probably cooled further, to an annual pace of 1.77 million, from a rate of 1.8 million in July.

FOMC MEETING Wednesday, Sept. 20, 9 a.m. EDT » The Federal Reserve's Open Market

Committee gathers to discuss monetary policy. Most of the economists surveyed by Action Economics expect the Fed will stay on the sidelines, keeping interest rates at 5.25%.

### LEADING INDICATORS Thursday,

Sept. 21, 10 a.m. EDT » The Conference Board's August index of leading economic indicators is forecast to have held steady. A drop in housing starts helped pull the July index down 0.1%.

The BusinessWeek production rose to 284.3 for the week Sept. 2, a 12% increase from previous year. Before calculating the four-week moving average index climbed to 285.4.

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# It Runs in the Family

**DYNASTIES** Fortunes and Misfortunes of the World's Great Family Businesses

By David S. Landes; Viking; 380pp; \$25.95

The appointment of an outsider to succeed William "Bill" Clay Ford Jr. as chief executive officer at Ford Motor might have gone differently if Uncle Henry Ford II were still alive. Back in the 1970s, things got ugly between Henry and his ambitious, hard-charging No. 2, Lee Iacocca. Ford hired investigators to

discredit Iacocca, to no avail. Iacocca, a favorite of the board for such successes as the Mustang, in turn gathered dirt on Ford's womanizing and tried to convince directors he was senile. At that point, Ford gave the board an ultimatum: "It's me or Iacocca." Ford quickly axed his colleague, a humiliation Iacocca avenged by landing atop rival Chrysler as chairman.

Iacocca's problem may have been insoluble—and may be something new CEO Alan R. Mulally will one day face. "He was not family," historian David S. Landes says in *Dynasties: Fortunes and Misfortunes of the World's Great Family Businesses*. "When he became too powerful, he had to be forced out."

Ah, the travails of the family-controlled businesses. Given Ford's woes lately, one can only wonder whether it would be in better shape now if Iacocca had stayed put. True, Ford didn't sell out to foreigners as Chrysler did, but it is slipping fast as rival Toyota Motor charges ahead. Landes, whose tales of Ford end in about 2002, didn't foresee Mulally or Bill Jr.'s plan to stay on as chairman over him, but the news certainly fits. As Landes suggests, "Founder Henry must be spinning in his grave."

Such dishy stuff and Landes' elegant touch make *Dynasties* fascinating. John D. Rockefeller Jr., we are told, grew up in such a tightwad family that he was made to wear his older sisters' dresses as a child, a torture his father also had to endure as a boy. Occasionally the book is even scandalous: We learn that Virginia Bourbon del Monte, the half-American widow of Eduardo Agnelli, heir to the Fiat fortune, died in the 1940s in a car crash with a male friend. As Landes delicately puts it, she was "amusing the trouser-less driver, who lost control in the wrong place and at the wrong time." Unfortunately, Landes fails to go beyond such juicy anecdotes to offer a compelling analysis of family-dominated enterprises. Are they the true creative forces in business? Are there ways to avoid management grief when the bloodlines

thin in later generations? Landes doesn't come to grips with such issues as he moves from tale to tale.

To be sure, there's plenty of grist for both inspiration and distress. The Rothschilds, the famed bankers, sprang from ghetto in Frankfurt that was a "barren, stinking cage." They learned to rely on family, but over time they proved insular that in the 1800s they encouraged marriages between uncles and nieces or first cousins. "Only a Rothschild was good enough for a Rothschild," snipes Landes. Likewise the Toyoda family in World War II was pressed to skimp on civilian work to push Japan's military effort, so it churned

Toyota trucks with single headlights, braided only on rear wheels, and wooden bumper. "downright dangerous modifications, but in the middle of a brutal war, accidents with automobiles were only one of many ways to die." Later, we learn, the Toyodas were spared by U.S. Korean War spending on trucks.

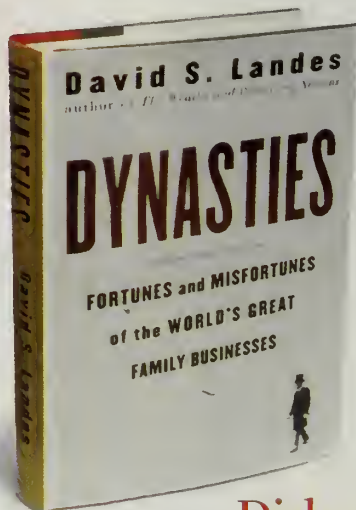
Landes offers scores of grace notes about commercial families. French automaker Robert Peugeot, fretting over family control, insisted that shares in the family company never pass to daughters or sons-in-law, a practice that drove one daughter into a 17-year court fight for her legacy; she would up leaving France. And we learn that even though Guggenheim males, heirs to a million fortune, were "not particularly attractive," they married "women who could hold their own in a beauty contest."

Regrettably, such notes do not add up to a symphony. Landes, a professor emeritus at Harvard University who wrote brilliantly in 1998 about uneven economic development in *The Wealth and Poverty of Nations*, doesn't get top grades for this book because he has failed to make clear points build into coherent argument. Family businesses are in for an "obsolete and inconsequential

as some champions of "professional"—i.e., nonfamily—management would have it, he says. But he doesn't mirror the data to prove, say, that such outfits are wellsprings of innovation. Nor does he spell out why some families rise from adversity while others fail.

Still, today's family business leaders will want to pore over the pages to glean lessons. Even though the book begs for a better look at the forest, the many trees Landes describes—the fascinating family trees—make for an intriguing read.

—By Joseph



**Dishy stories about heirs and widows, but no solid advice to take away**



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## Boone Pickens Follows the Oil

**THE LEGENDARY** Texas oilman T. Boone Pickens was at his ranch in the Northeast Panhandle holding the yearly meeting of his hedge fund BP Capital when I caught up with him. I reminded him that in May, 2005, he predicted that gasoline would hit \$3 a gallon. Nice call. Now, despite recent declines, from a spot-market high of \$78.84, according to *Platts*, Pickens is not writing off another surge in oil prices.

**The price of oil has fallen from its highest levels. Has the peak been seen yet?**

Well, let's go back to what I said. Didn't I tell you we would see \$80 oil? We saw almost that. [The oil market] has done exactly what we expected...it just fell off faster than we thought. But you are still confronted with the geopolitical problems we've been facing for a couple of years. Right now the economy is slowing. Demand is slowing. But we are talking about a short period of time here. You will have to have some geopolitical event to get to 80 again before [2007], but we will see 80 in a normal market next year.

**The recent discovery in the Gulf of Mexico is said to be one of the biggest finds in history. How significant is this?**

It was a nice discovery. Is it going to make any difference in the price of oil? No. I have heard reports it's 15 billion barrels...that would be larger than Prudhoe Bay. I think the discovery [will prove to be] much lower. Will it impact gas prices? No. Hats off to Chevron, Devon, and Statoil, but it'll take several years to get it into production.

**Speaking of Prudhoe Bay, what about the breakdown of the BP pipeline there that's causing disruptions in Alaskan oil?**

BP is a tightfisted operator, and they pushed too far. A culture of being too tightfisted can develop in an organization, and I am not so sure that hasn't happened at BP. When it does, it starts to show up in your maintenance. I wouldn't

put any money in BP right now. [Pickens' firm, BP Capital, has no connection to BP.]

**Will other discoveries be found in the Gulf?**

Sure. There are a lot of geologists working hard in the area, and there no doubt will be other discoveries in the water. Will it change the direction [of the market]? No. I don't think there is anything big enough to change the direction. We are dealing with declining curves around the world. We can add helps, but the best additions come from Saudi Arabia because they are spending money and drilling a lot of



### SNAPSHOT

**HORSE LOVER** Pickens has been helping lead the campaign against the horse meat business. "The brutal slaughter of horses for consumption by wealthy diners in Europe and Japan cuts against our moral and cultural fiber. It's just plain un-American. The House listened to the public and passed the American Horse Slaughter Prevention Act [on Sept. 7]. Now the Senate should do the same."

**Aren't you worried about being so dependent on Saudi Arabia?**

I don't worry about anything, but I am concerned about things. The fact that we are dependent on the Mideast for 25% of the total that we import. If you have to deal with it, but I'm not going to worry about it. The biggest export to the U.S. is Canada, and we look at the 8 or 10 countries that are oil from, there are only maybe three that are somewhat neutral. Others are not friendly. We have a good job of lessening our dependence on our enemies. But our only real friend is Canada. That does concern me.

**Won't advances in drilling technology continue to change the business?**

It's much different today than 10 years ago, but you can't keep improving at the rate that we have been improving.

**How do you make money in the oil business as an investor?**

BP Capital, which was up 100% last year, has struggled this year, but we are up 25%. I don't like companies that place their production, and that is the case with the Canadian oil sands, and that is the company I said I would be in for the

years is Suncor. We think it's a good time to buy oil, that will hold at 65, and that the economy will grow 2%-2½%, which will slow everything down. We are looking at next year to see how our plays will be.

Maria Bartiromo is the anchor of CNBC's Closing Bell.

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# Ideas The Welch Way

BY JACK AND SUZY WELCH

## The Rumsfeld Conundrum

**Forgetting politics, how long would you continue to employ Defense Secretary Donald Rumsfeld? He appears to have done a poor job planning and executing the war, and he has evidently lost the respect of the people who work for him. How do you look at this from a management perspective?**

—Jeff Moskow, Las Vegas

You can't forget politics in this case because Cabinet appointments are all about politics. In fact, you can't really evaluate this situation from a strict management perspective, although it's perfectly natural for a businessperson to want to do that. Government is not business, especially when it comes to dealing with performance issues.

To understand what we mean, consider the recent spate of high-profile corporate departures. Bill Ford basically fired himself as CEO, stepping down from the family company he had run for five years. After more than two decades of close collaboration, Sumner Redstone asked Tom Freston, CEO of Viacom, to move on. And in an opposite scenario, Dave Calhoun, a vice-chairman at GE, was lured to the private-equity world with an offer to run the privately held Dutch company VNU Group.

All three of these departures caused reactions from surprise to disappointment—Freston's was particularly unexpected—but otherwise occurred without incident. The transitions were swift and smooth. Ford, who will stay involved as chairman, announced his resignation as CEO at the same time he named his successor, Boeing executive Alan Mulally. Freston was immediately replaced by a longtime Redstone adviser, Philippe Dauman, and within days was given a splashy send-off. Calhoun's job was filled instantly by another strong GE executive, John Rice.

Now imagine what would happen if President Bush accepted the resignation letter Rumsfeld says he has tendered several times. Forget swift and smooth. All partisan hell would break loose, culminating in the confirmation hearings for Bush's nominee. Without a doubt, Bush would nominate someone closely aligned with his mission. So those hearings would surely last months, with both Republicans and Democrats using them as a big fat media opportunity to conduct a kangaroo trial of not just U.S. policy in Afghanistan and Iraq but also the entire Bush Presidency. Who would run

**Replacing  
a Cabinet  
officer is  
far more  
problematic  
than installing  
a new CEO**

the war during this political slugfest? Everyone—and no one—wants to see what a dangerous mess.

Business can be political, of course, but in a company setting, letting people go doesn't present the same kind of peril or complexity. Indeed, as the departures mentioned above show, top managers can leave with a minimum of upheaval, especially when successors are put in place immediately. That keeps the machine running and shows the all-important message that no individual is indispensable or bigger than the organization. In the best-case scenario, jobs should be filled within eight hours.

Almost nothing in government happens in eight hours. Forget looking at the Rumsfeld situation from a management perspective. It can only be seen through a political filter.

**How can a low-level employee initiate change in an organization that has stuck with the status quo for a long time?**

—Anonymous, Nairobi, Kenya

You can't. Or 99% of the time, you can get killed trying.

Look, most organizations these days understand the need for continual change. They accept the fact that if they don't constantly improve, they will be lost in the competitive marketplace. They also know that people generally resist change and must be goaded into it by a passionate change agent. But it's rare that a company wants the rallying cry to come from the mouth of a junior player without dirt under his nails and sweat on his brow. That's why, at most companies, change is initiated at the top—or at the very least, by middle managers who have earned their stripes with years of great results.

So if you want to change your organization, follow the lead. As an individual contributor, don't just deliver—overdeliver. Do what is expected of you, and more. Work harder, make your boss smarter, her life easier, and your whole team's performance better than ever. It may take time, but eventually you will be rewarded with a team of your own. You can make it a model for the kind of change you imagine. And that effort succeeds, eventually you will win the respect, authority, and higher-level positions you need to initiate the kind of wide-scale campaign you so desire.

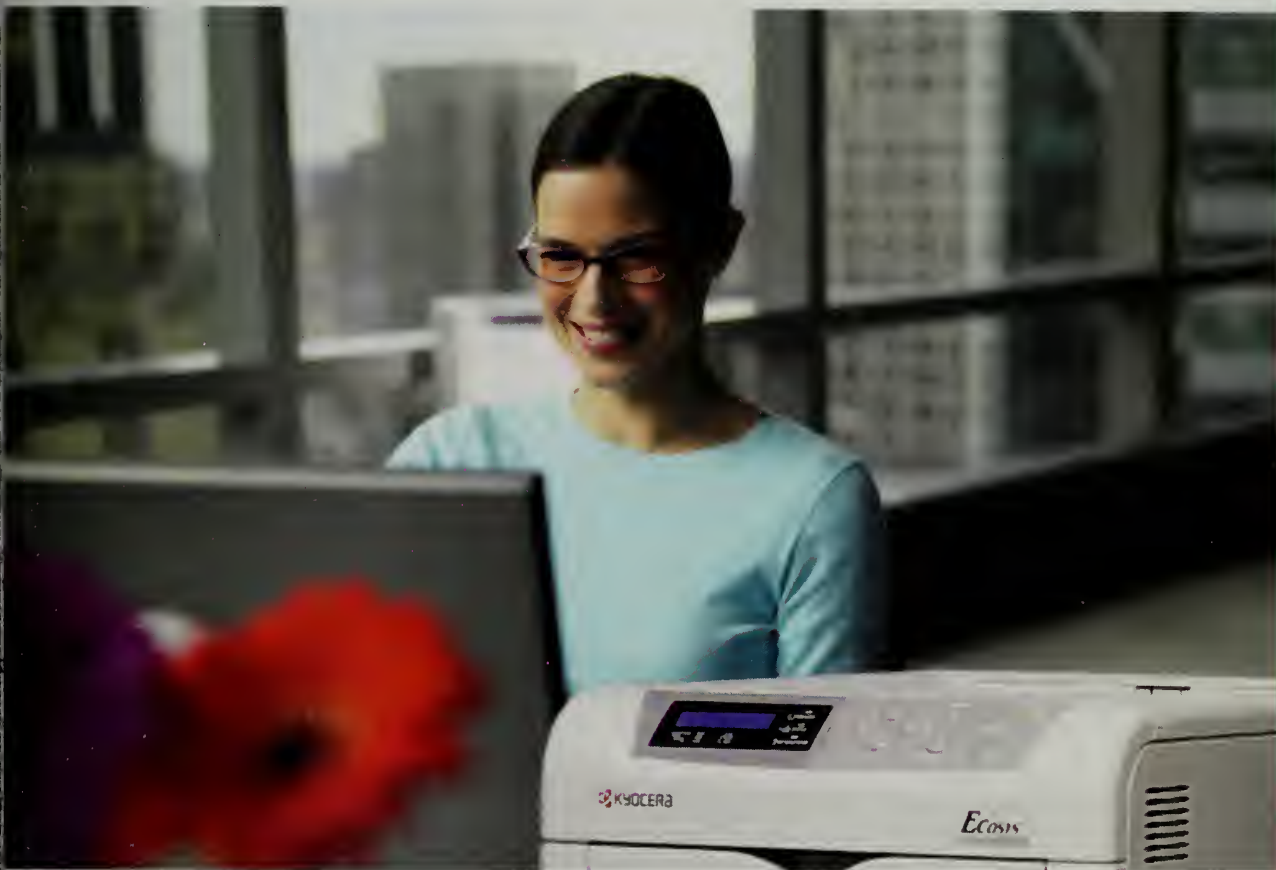
If our "work and wait" answer leaves you frustrated, perhaps you need to move on. Next time, though, join a company you love as it is, not one you want to make over especially from the bottom up. ■

*Jack and Suzy Welch look forward to answering your question about business, company, or career challenges. Please e-mail them at [thewelchway@businessweek.com](mailto:thewelchway@businessweek.com). For their weekly podcast, go to [www.businessweek.com/search/podcasting.htm](http://www.businessweek.com/search/podcasting.htm)*

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## click fraud



### The Dark Side Of Online Advertising

**A BUSINESSWEEK  
INVESTIGATION**

**BY BRIAN GROW AND  
BEN ELGIN PAGE 46**

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On his way to work,  
Brian started to think  
about how changing  
applications could  
dramatically speed  
up product design.

Right after that, a  
server overheated  
and he spent the day  
shopping for fans.

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### PAY FOR CLICKS

The Strucks made over \$5,000 in four months by setting up dummy sites and paying others to generate Web traffic



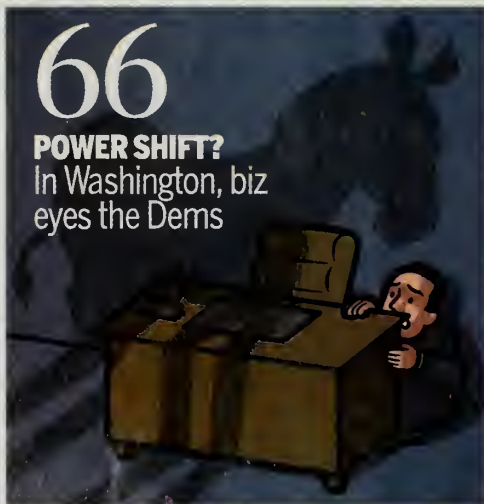
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## Home Economics

With the housing market softening and lending rates at solidly higher levels, a big home improvement project is not undertaken lightly. Our BusinessWeek.com special report on **Home Improvement That Count**, offers essential information and smart strategies to help would-be remodelers tackle the array of choices that await them.



An Elmira Stove Works retro stove

We start by examining the factors BusinessWeek.com editor Will Andrews and his family weighed as they made the decision to **remodel, move, or stand pat**. Advice from experts is always welcome, and we have some **common-sense tips** from home-improvement guru Bob Vila. Two tip sheets offer help on making **smart financing choices** and achieving high style on a modest budget. We also take a close look at the surprising financial implications of using **"green" building materials**. Before you call the bank or the architect, see our slide shows on the **projects that create the most value** and **high-end appliances** and their more modestly priced look-alikes. For all this and more, go to [www.businessweek.com/go/06homeimprovement](http://www.businessweek.com/go/06homeimprovement)

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# JP Front

"Our intention was to have a very successful summer sale.... That expectation was wrong."

—DaimlerChrysler Chairman Dieter Zetsche on a failed employee-pricing promotion that contributed to Chrysler's expected \$1.5 billion third-quarter loss, in Detroit Free Press

EDITED BY DEBORAH STEAD

## AD BETS HEAPER OIL, IT NOT FOR OST AIRLINES

RECENT MONTHS, when oil peaked at \$70 a barrel and was expected to fall, some forecasters predicted a drop to \$100 by yearend, but major airlines did what they could to hedge. They locked in fuel prices, locking in much of their short-term fuel needs at current prices. But with oil now under \$60 a barrel, a nearly 20% drop from late July's peak, airlines are paying more for fuel than if they simply hedged the spot market. Continental made the worst mistake, hedging 33% of its third-quarter requirements at \$18 a barrel and 27% of

its fourth-quarter needs at \$75.20. Others misread the future almost as badly. Northwest pre-bought 25% of its fuel for 2006's second half at \$65 to \$79.40, while US Airways Group hedged 44% of its third-quarter consumption at \$71.39. Only Southwest is coming out ahead—way ahead. Thanks to deals it signed long before prices shot up, it locked in 73% of its second-half burn at an enviable \$36 a barrel.

Despite the flubs, there isn't much finger pointing inside the industry. Overall, falling oil prices are a net plus for carriers. "They may be back in the money by yearend," says Raymond Neidl, an analyst at Calyon Securities. —Michael Arndt



## THE BIG PICTURE

THEY MAY INTONE MANTRAS citing the importance of front-line

employees, but a new survey shows that managers seeking advice tend to ignore lower-grade workers, the ones who "actually make the stuff or are dealing with customers," says Gary Cohen of CO2 Partners, who commissioned the study.

EMPLOYEES WHO SAY THEIR BOSSES "OFTEN" ASK THEM FOR ADVICE:

|                                           |     |
|-------------------------------------------|-----|
| Those with high school diploma or less    | 24% |
| College graduates                         | 54% |
| Those earning less than \$25,000 annually | 30% |
| Those earning more than \$75,000 annually | 52% |

Survey of 599 employees, Aug. 25-29, 2006. CO2 Partners: International Communications Research

## PHILANTHROPY

## Shop (In the Name of Love)



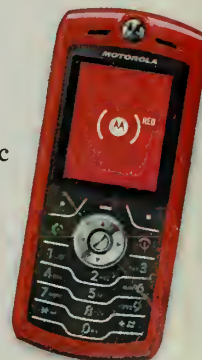
GET READY FOR RED. Bono, along with Bobby Shriver of the Kennedy clan, is bringing Product RED—his conscious-consumer campaign—to the U.S. in mid-October.

Judging by RED's success in Britain, where the cause-related marketing venture has become chic among millennials and hip "influencers," consumers will soon be seeing RED everywhere. In Britain a red American Express card, which reads "This card designed to help eliminate HIV/AIDS in Africa," now carries more cachet than the elite Black card. So far this year, Britain's RED campaign has generated \$5.2 million for the Global Fund.

Here in the U.S., RED is teaming up with iconic names to pump out some cool, co-branded products—including Motorola phones, Converse sneakers, Gap T-shirts, and the wraparound Emporio Armani sunglasses that Bono wore during U2's last world tour. Consumers buying the items are ensuring that up to 50% of the profits will go to the Global Fund, which fights AIDS in Africa.

RED is emblematic of the new philanthropy, which is less about handouts and more about hybrid models that mix profits with solving social problems. (Think Omidyar Network, the venture-capital-like foundation of eBay's Pierre Omidyar, and Google's for-profit charity.) With RED, companies looking to bond with consumers in an age of split-screen attention spans also get the benefit of Brand Bono.

—Michelle Conlin





## BALLPARK FIGURES FREAKONOMICS VS. MONEYBALL

**FREAKONOMICS** author Steven Levitt has repeatedly criticized *Moneyball*, Michael Lewis's 2003 best-seller that says the Oakland A's used statistical analysis to win games with moderately paid players. Lewis argued that the A's won on the cheap in part by telling batters to draw walks by being patient at the plate. Levitt countered that the team's powerful pitching was the key to its wins.

Last year, Levitt rejected an academic study that endorsed the book's findings, saying it didn't prove its

point persuasively enough to be published in the University of Chicago's prestigious *Journal of Political Economy*, of which he is co-editor. ("We reject 94% of the papers that are submitted," Levitt notes.) Authors Raymond Sauer of **Clemson University** and Jahn Hakes of **Albion College** managed to get the paper into the latest issue of the not-quite-so-serious *Journal of Economic Perspectives*. Sauer isn't troubled by Levitt's rejection. "He had very insightful comments," he says. "It was a cordial exchange."

And it's one that may continue: So far this season, the A's have the fifth-best record in baseball—with both a middle-of-the-road payroll and some fine pitching.

—Peter Coy



## PORT-O-PROMOTION

**SPACE AGE MARKETING** meets port-o-pottie with Micro Target Media's **new ads, which will** around (and appear inside) portable restrooms. This summer the ads popped up at events such as the Indy 500 and Major League Baseball's All-Star Game. Up next: Munich's Oktoberfest. Toronto's MTM may be the first use radio frequency identification (RFID) and GPS to pinpoint portable restrooms in strategic locations—at a construction site near a new McDonald's outlet, for instance. MTM will also begin counting port-o-potty ad views in real time, using infrared beams and mechanical counters on the restrooms' doors. The company says it is positioned to put ads on about 500,000 portable restrooms worldwide.

—Elizabeth Wo

## BLOGSPOTTING CULTURE AND COMMERCE [www.cultureby.com](http://www.cultureby.com)

» **WHY READ IT** Because Grant McCracken—an anthropologist and corporate ethnography consultant—is witty, opinionated, and razor sharp. "This blog sits at the intersection of anthropology and economics," he announces to his readers. And it does. His posts filter marketing and commerce through a cultural lens and vice versa. In the process, he offers smart takes on everything from "chunky" markets (the growth in the audience that lies between mass consumers and "long tail" niches) to the branding quandary Apple faced when it put Intel chips into its Macs.

—Jena McGregor

## DRAWN & QUARTERED





# Brian Shafley came to Ohio by design. His experience kept him here.

With a client list that includes many of the world's most recognized brands, Chute Gerdeman maintains a creative, enjoyable work environment. Away from the office, Brian and his family enjoy many hours together in Ohio's great outdoors.



## BRIAN SHAFLEY'S STORY

**"Balance and options are what we enjoy most about Ohio, both in business and in life."**

Brian Shafley, President  
Chute Gerdeman

Armed with a keen insight into the modern retail environment, Elle Chute and Denny Gerdeman believed they could create an ideal design firm. Two early, important decisions helped assure their success: They located in Ohio. And they chose Brian Shafley to lead their creative team.

Founded in 1989, Chute Gerdeman specializes in creating a real-time brand experience at the point of sale for such prominent clients as Disney, M&M's® World, Target, Levi Strauss and Smithsonian. An acknowledged leader in its industry, Chute Gerdeman was named Design Firm of the Year for 2006 by *Display & Design Ideas Magazine*.

According to Shafley, Ohio is ideal for the firm because it's a "Center of Gravity" in the retail business, with many retail and restaurant chains headquartered here. It also has a youthful creative community with a large, deep talent pool fed by a number of world-class creative arts schools.

Brian's life away from business is just as satisfying. He and his family have much more time together than when they lived in Chicago, enjoying a variety of recreational activities and Ohio's stable, safe, Midwestern pace.

Business and life in Ohio have been a great experience for Brian. It could be for you, too.

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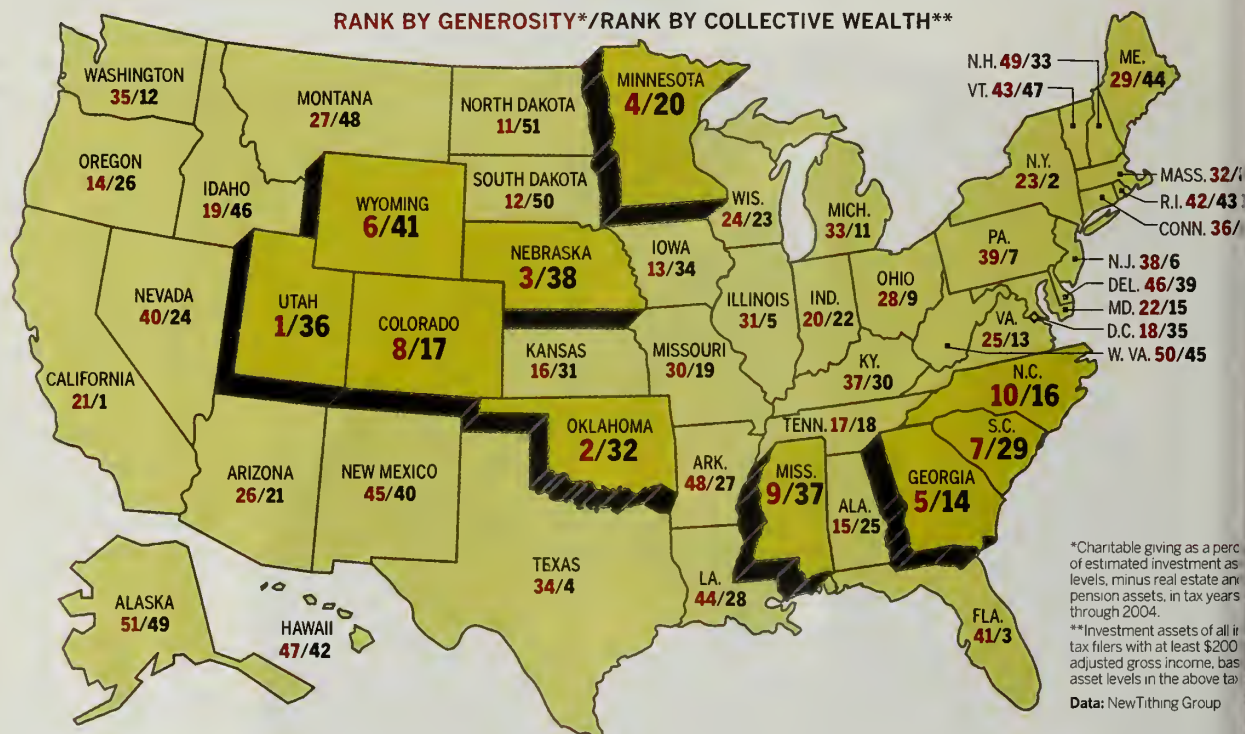


## STATES OF GRACE

### WHERE GENEROSITY LIVES

**PONY UP,** California and New York. Affluent taxpayers (earning \$200,000 or more) in those states have the highest aggregate wealth, measured by investment assets. But according to a six-year study from newtithing.org, a San Francisco think tank that analyzes charitable giving, they're only 21st and 23rd, respectively, in terms of generosity, collectively giving

about 0.74% of those assets to charity. By contrast, affluent Utahans Oklahoma donate 1.63% and 1.05%, respectively. If top earners in five wealthiest states gave at the rate of those in the five most generous, NewTithing says, total U.S. individual giving would rise by \$13 billion a year. Here, the rankings, with the Generous Top 10 highlighted.



## WEB NAVIGATION

### BUTTERING UP THE BLOGOSPHERE

**ONCE IT WAS** the domain of bandwidth-munching cranks. Now the blogosphere is so important that business can't ignore it. But how to reach these opinionated critics?

Enter the blogger relations specialist. Public-relations firms are monitoring posts and chatting up bloggers to gain credibility. Blogger relations at **Topaz Partners**, based in Woburn, Mass., have taken off in the past six

months, says Todd Van Hoosear, who oversees those relationships as "social media practice" manager. Paul Rand, chief development and innovation officer at Ketchum, says PR firms not partaking of the trend are "conspicuous by their absence."

Successful reps "hide in the weeds for three to six months, reading, occasionally posting a comment," says Sam Whitmore, who analyzes tech coverage at **mediasurvey.com**. They pitch, sending a personal e-mail, only after establishing ties.

Not everyone gets it right. Robert Scoble, of the popular tech blog Scobleizer, says that

after blogging about his mother's death, he was cold-pitched by reps, and "it was obvious they hadn't read my blog." CEO Richard Edelman



of PR firm Edelman, how donated \$500 to the National Park Service in the name Scoble's mother. After hearing about the "ill-informed PR people," Edelman said, "I felt it was the least I could do."

As more PR agencies cl bloggers, former **Apple** marketing guru Guy Kawasaki has even provided a playbook on his blog. Bloggers need "stroking," noted playfully in "How to Suck Up to a Blogger," posted earlier this year. And gifts which "dollar for dollar" "one of the best marketing investments."

—Nichola Samina

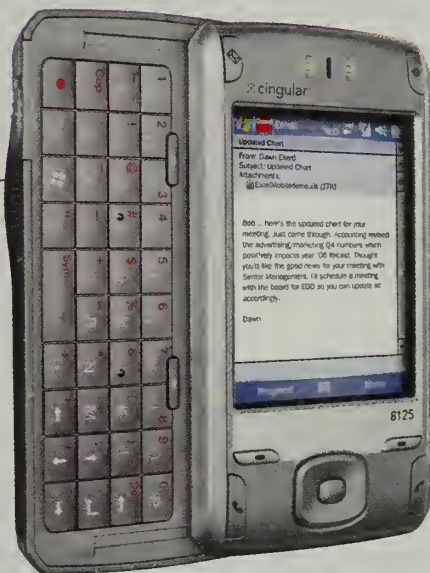


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## SECURITY IF THEY CAN'T SEE, THEY CAN'T STEAL

**STORES ARE STARTING** to smoke out burglars—literally. Looking for security systems beyond alarms and unsightly iron roll-up gates, some retailers are trying a newer deterrent: a fog machine. Once the system, installed in a corner or on a wall or ceiling, is triggered by

someone breaking and entering, it takes just a minute to create a dense, nontoxic fog that obscures visibility. Burglars can panic, groping their way out of the store without stealing anything. That's what happened during a recent break-in at a **CVS** in Florida, one of a handful of outlets at which the drugstore chain is testing the device.

The fog makers are gaining popularity, according to one distributor, **Smoke &**

**Screen Security Systems**, which says its sales to U.S. retailers more than doubled last year. Although President Kevin Paul says the system isn't designed to be "a man trap," it could end up snaring a would-be thief caught in the fog, which is similar to theatrical smoke, until the cops come. (The system is linked to an alarm that summons police.) "It's like something Mel Brooks might have scripted," says John Feretich, head of security at clothing chain **Rainbow USA**, which is testing fog devices in some stores. (No trapped burglars yet, he says.)

At just a few thousand dollars, a fog system can be far less expensive than metal gates. But there are potential downsides. "Is it so theatrical that I could have kids standing outside and throwing rocks at my window just to see it?" wonders Feretich.

Then there's the specter of the litigious burglar who injures himself on the foggy premises and eventually gets away with much more than he came for. —Louise Lee

## B-SCHOOLS MBA STUDENT ARE NO. 1 —AT CHEATING

**ARE TODAY'S** B-schools breeding tomorrow's corporate crooks? Research to be published in **Academy of Management Learning & Education** found that 56% business grad students admitted to cheating in the past academic year. That's more than the 47% of nonbusiness grad students making the same admission.

The study, co-authored by Linda Treviño, a professor of organizational behavior at **Penn State's Smeal College of Business**, looked at surveys of 5,331 graduate students at schools in Canada and the U.S. Do B-school students cheat even in ethics courses? "I know of situations where that's happened," Treviño said. —Lindsey G.



## QUESTION OF THE WEEK

Paul Wolfowitz's anticorruption drive at the World Bank, part of which involves delaying aid to poor nations, came under fire at the bank's recent annual meeting in Singapore. Should honest government be a prerequisite for receiving aid?

—Nichola Saminath and Elizabeth Woyke

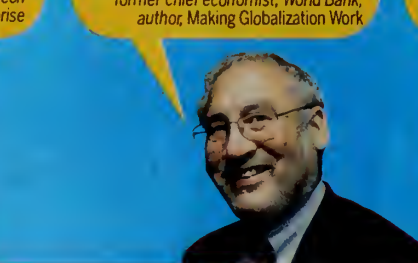
**"Aid embargos don't stop corruption—they only worsen the economic situation. Ensuring that aid reaches the real beneficiaries involves a reliable chain of delivery. Local NGOs are increasingly playing this important role."**

Kiran Mazumdar-Shaw, chairman and managing director, Biocon, India's largest biotech enterprise



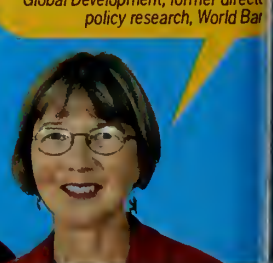
**"Corruption ought to be attacked. But an honest yet totally incompetent government is just as much a waste of money as a corrupt one. You don't walk away from a country because its leaders are corrupt. You work through other channels."**

Joseph Stiglitz, Nobel laureate; former chief economist, World Bank; author, *Making Globalization Work*



**"It's difficult to make these trade-offs. What do you do when the top leadership is corrupt but health and education program managers are delivering at the bottom? I give Paul Wolfowitz credit at least for pushing the issue that generated this debate."**

Nancy Birdsall, president, Center for Global Development; former director, policy research, World Bank



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"The time for homeowners to act is [before] the loan has become delinquent or enters default."

—Kenneth D. Wade  
 NeighborWorks America  
 Washington



Last week we published a collection of letters and online postings regarding our Sept. 11 Cover Story "Nightmare mortgages" (Feedback, Sept. 25). Additional reader comments are posted at [businessweek.com/go/06mortgage](http://businessweek.com/go/06mortgage).

### NIGHTMARE MORTGAGES: MORE REPORTS FROM THE FRONT

I WANT TO COMMEND *BusinessWeek* for "Nightmare mortgages" (Cover Story, Sept. 11), a timely exposé on the exotic new mortgage products that have dominated the lending world for the past several years and that can be dangerous when misunderstood and misused.

As Commissioner of the Federal Housing Administration, I have been making this case for the past year in an effort to focus the attention of lawmakers, industry representatives, and the general public on this disturbing trend. Too many families have been steered into high-cost and high-risk loans, particularly minorities, first-time home buyers, and families with less-than-perfect credit. These types of home buyers have traditionally relied on FHA-insured financing as a safe and affordable means to obtain market-rate financing. Unfortunately, FHA insurance has not been a viable home financing op-

tion in recent years due to antiquated requirements and procedures, including minimum downpayment requirement and limits on the mortgage amount.

The Bush Administration has posed a set of changes to FHA in a now pending in Congress, the Expanded American Homeownership Act of 2006 has received overwhelming bipartisan and industrywide support, passing in House by a vote of 415 to 7, and is pending in the U.S. Senate.

—Brian D. Montgo  
 Assistant Secretary for Housing  
 U.S. Housing & Urban Development  
 Washington

CONTRARY TO STATEMENTS made in your publication, mortgage brokers, bankers, and lenders serve an important function: We help people purchase affordable homes. Your "explanation" of the popularity of "pay option" adjustable mortgages is to cast blame on mortgage brokers for steering consumers into loans that pay the highest commissions. accusations are false. Steering is illegal and in fact there is no clear advantage to the broker in selling these loans. A better explanation is the simplest: Most pe-

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## CORRECTIONS & CLARIFICATIONS

the man behind Apple's design magic" (Inside Innovation, Sept. 25) should have said that Apple Computer Inc. stock has risen 1,273% in the past 10 years, not 2%. Also, the PowerMac G4 Cube was discontinued in 2001, not 2000. And the Newton operating system supported handwriting recognition, not voice recognition. The final sentence should have read "...the Steve and Jony Show should continue to roll along just fine."

Up Front (Sept. 25), "Adding some sparkle to QVC" incorrectly reported QVC's annual revenue. It is \$6.5 billion. And the question of the week "gave an incorrect answer for Harvey L. Pitt. He was chairman of the Securities & Exchange Commission from 2001 to 2002.

"Nightmare mortgages" (Cover Story, Sept. 25) should have specified that while there are no federal regulations for mortgage brokers, individual states have widely varying requirements.

At the lowest possible payment, and to believe the value of their homes will increase. Although many people extend themselves to purchase the most house they can afford, they count on lenders to push the limits of their creditworthiness. For many of the pay-option ARMs, low prices and easy qualifying underwriting guidelines (both established by the mortgage funds) left little room to maneuver as interest rates rose.

The National Association of Mortgage Brokers has always suggested that improved financial literacy would be a benefit to the consumer. However, we believe this is a systemic problem that will be solved only when our elected leaders address housing affordability. In the case of pay-option ARMs, mortgage brokers and lenders represent the first point of contact with customers, but it is the Wall Street mortgage funds that set pricing and underwriting guidelines. If you want to fix the problem, that is the place to start.

Most mortgage brokers are honest, knowledgeable, well-meaning, hardworking small business owners. We do not want to afford to mislead, upsell, or do anything that will tarnish our reputation in our communities.

—Harry Dinham, President  
National Association of Mortgage Brokers  
McLean, Va.

EXPECTATION of a surge in troubled assets, earlier this year NeighborWorks

America launched the national Center for Foreclosure Solutions, operated in partnership with the Homeownership Preservation Foundation and supported by more than a dozen financial institutions. Through the Center's toll-free hotline—888 995-HOPE—borrowers can obtain free foreclosure prevention services and counseling and get connected to local nonprofit organizations that can provide direct assistance. The time for homeowners to act is now, not after the loan has become delinquent or enters default.

—Kenneth D. Wade, CEO  
NeighborWorks America  
Washington

## SUGGESTIONS FOR SUSTAINABLE SEAFOOD

RE "FISHED OUT" (Special Report, Sept. 4): The vast majority of U.S. fisheries are well-managed. According to the NOAA's National Marine Fisheries Service report for 2005, 81% of U.S. fish stocks assessed are sustainably managed. In 2004, Americans consumed a record 16.6 pounds of seafood per capita. Because we need to grow enough fish to meet demand, fish farming is part of the future of the industry and a complement to wild-capture fisheries—not a replacement for them.

We look forward to congressional passage of legislation this year to reauthorize the Magnuson-Stevens Fishery Conservation & Management Act, the law managing our nation's fisheries. The seafood industry works to ensure an abundant supply of high-quality fish for generations to come and is committed to the survival of both fish and fishermen.

—John Connelly, President  
National Fisheries Institute  
McLean, Va.

"FISHED OUT" overlooks an important point about Individual Transferable Quotas (ITQs): In the case of the haddock fishery, to enter the fishing business it would cost nearly \$1 million to buy enough quotas to produce \$180,000 in income. And that doesn't include the price of the boat. That would effectively exclude owner-operators without large amounts of money from entering the business as older ones retire. A fairer and more equitable system would issue quotas for the total amount each boat can catch rather than the number of days fished. That would have the same effect on fish supplies but would remove the bias toward corporate ownership. The quotas could be issued annually, permanently, or for multiple species.

—Willis Craig  
Sebastopol, Calif.

ENVIRONMENTAL DEFENSE is working with fishermen and managers around the country to design and implement individual fishing quotas, fishing cooperatives, and other systems to make conservation a winning business proposition.

For example, we are linking major suppliers and retailers of seafood to consumers demanding "ocean friendly" seafood. With community bankers and small-boat fishermen in California and Massachusetts, we are designing cooperatives that can aggregate and manage shared-fishing quotas, thereby transforming marginalized fishing enterprises into profitable ones. By working directly with investors, we are identifying ways in which private capital can be brought to bear (either for profit or more philanthropic investments) to accelerate the transition to well-managed fisheries. Businesses can play a key role in restoring our oceans.

—David Festa, Oceans Program Director  
Environmental Defense  
Washington

## NOW A WORD FROM CRAIN'S CHICAGO BUSINESS

YOUR STORY ON McDonald's Corp.'s sundial billboard ("Street stunts on the digital highway," Marketing, Sept. 11) may have caused some confusion about our Web site, [chicagobusiness.com](http://chicagobusiness.com). As the online arm of *Crain's Chicago Business*, it is not a "regional trade site," as the story says, but a site that covers general business news in Chicago. Also, Leo Burnett did not place a photo of the billboard on our site. We posted the photo to our site with a story we reported and wrote on the billboard's role in McDonald's campaign to expand its breakfast business.

—Joseph B. Cahill, Editor  
Crain's Chicago Business  
Chicago

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# Still Not Ready for Prime Time

With the entry of the Apple iTunes Music Store and Amazon.com into the movie business, film downloads are finally being sold by folks who really know how to sell entertainment. This is a big step in Hollywood's glacial crawl into the Digital Age. But the limitations of the offerings suggest the online distribution will remain mostly a novelty for the foreseeable future.

Amazon quietly announced its Unbox service on Sept. 11, and the iTunes movie store was announced the next day. As you would expect, both services are well-designed and easy to use. (Unbox's classifications still need a little work. Its title notwithstanding, *Pee-Wee's Big Adventure* is not an Action & Adventure movie.)

Right now, the pickings on both the Amazon and Apple sites are slim. Unbox launched with "thousands" of titles from seven studios, but Amazon won't be more precise, and many of those "titles" are episodes of TV shows. iTunes starts with just 75 Walt Disney movies. While those numbers should grow quickly, the bar is set by Netflix, which offers more than 65,000 titles for rent. Both Amazon and Apple have priced their films at \$10 to \$16. For some movies, Amazon also offers \$4 "rentals," which are usable for 24 hours once opened.

**BOTH SERVICES CLAIM** "near DVD" quality, but that's a stretch. It's closer to broadcast TV, with Amazon having a quality edge. And watching an Unbox or iTunes movie isn't an impulse decision like choosing something from an on-demand cable service. Even on my fairly fast Comcast connection, it took more than two hours to download a feature film. If you want to watch a movie without interruption while it's arriving on your hard drive, you'll need to start the download a good hour before you want to watch.

The bigger problem is the viewing experience. Both iTunes and Unbox let you watch your movie on one or more computers (Windows-only for Amazon). Unbox films can also be watched on handhelds, such as Toshiba's Gigabeat, that use Microsoft Portable Media Center software. iTunes movies can be downloaded to iPods, though Apple's updated line does not include a much anticipated widescreen video iPod. Sometimes you will want to watch a movie on a computer screen—on an airplane or perhaps if you live in a dorm room. But most of us, most of the time, would rather see *Pirates of the Caribbean* on a big-screen TV.

This is possible but far from easy. A few people have a PC or Mac connected directly to their TV sets; the best computers



**Movie downloads can't be easily viewed on a TV. But Apple plans to fix that**

for the job are some expensive Media Center PCs or the cheap Mac mini. In theory, you can stream video over a network from a Media Center to an Xbox 360 jacked into the TV, but the quality leaves a lot to be desired.

Apple promises to solve the problem early next year when it introduces a \$299 product with the working title of iTV. Apple gave an impressive demonstration of iTV on Sept. 12, but I have seen too many impressive demos of products that either never materialized or fell short of their promise.

Apple's toughest challenge is getting the massive amount of data required for video from a computer running iTunes software to an iTV connected to a television. New wireless technology may allow for reliable delivery of standard-definition TV this way. But Apple raised the stakes by demonstrating high

definition TV, which is at least an order of magnitude harder.

I really hope Apple succeeds where Microsoft and others have failed. The amount of quality video available for download to computers is growing daily, but the challenge of putting that video where people want to watch it has so far been insurmountable. And the reluctance of the studios to buy into the digital vision has kept much of the best content out of reach. Apple revolutionized music with the iPod and iTunes. Maybe it can work its magic again with video. ■

E-mail: [tech&you@businessweek.com](mailto:tech&you@businessweek.com)

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**SUEZ**





# The Uncool Success of Rodale

High school cliques recur endlessly, and nowhere more so than within the Manhattan-centric world of magazines. The popular (read: mean) girls are at Condé Nast Publications. Student-government and school-newspaper types flock to Time Inc. When it comes to who sits where in the cafeteria, the Rodale table is nowhere near the cool kids. ¶ Rodale is run by CEO and



**MURPHY** Even detractors say he has done well

the 1940s. But Murphy is a bit of an outsider in New York media as well. He came to Rodale from Disney, not Condé Nast. Chatter about turnover in his executive ranks, which Murphy and Rodale dismiss, persists. If his industry peers compiled a short list of top executives, there's a good chance Murphy wouldn't crack it. And yet his track record at Rodale since his arrival in 2000 is likely as good as anyone's and better than most. Today the struggles of Time Inc., long the gold standard of the industry, earn it stepchild status at Time Warner, and suddenly someone in the out crowd looks good.

**MURPHY ARRIVED AT RODALE** after an impressive growth spurt had waned. From 1990 to 1997, Rodale's revenues doubled, to around \$515 million, but then began to slide. One early task was reorganizing the company, followed in 2001 by staff cuts. Combined with Murphy's outsider status, such moves did little to endear him to some of Rodale's tight-knit employees, several of whom were not shy about sharing their objections with reporters. (When asked about such comments, Murphy grins and mimes someone throwing a bomb his way.) But to a person they concede that Murphy has done a good job, an assessment the numbers bear out. Rodale's aggregate ad pages have risen during his tenure, which, given magazines' ill fortunes since 2000, is no mean feat. *Men's Health*, while soft this year, saw annual ad pages jump from 714 to 1,117

President Steven P. Murphy. He dresses well—almost too well. (Think three-piece suits in September.) He exudes the faint aura of a performer, of being aware he is being watched. Neither quality is common at the family-owned Rodale, based in Emmaus, Pa., which still retains the institutional DNA you'd expect from a company that has been popularizing “organic” since

between 2001 and 2005. And Murphy gave niche titles like *Runner's World*, *Bicycling*, and *Backpacker* a second wind through an old-school form of upscaling: adding longer-form narratives while virtually every other publication was truncating word counts. Note to publishers convinced that readers don't like to, you know, read: *Bicycling* and especially *Runner's World* have prospered under this strategy.

Some of this success is due to luck and prior groundwork. Rodale focused on health and what we now call “wellness,” which turned out to be a better niche than, say, mass-market women's service magazines. (Rodale's most prominent flagging title, the 3.3 million circulation *Prevention*, most closely resembles a women's service title.) It's true that *The South Beach Diet*, which was published in 2003 and sold at least 5 million copies, covers many sins. It's also true that Rodale built a *Marshall Stewart*-esque multiplatform business off that idea—a task at which many others have failed. (There is a uniquely Rodale way to communicate this notion: “I knew [Murphy] was the

right guy when he drew a mandala to describe the business model,” says Vice-Chairman Maria Rodale.)

With *South Beach*, Rodale cracked the code of getting consumers to ante up online, teaming with Waterfront Media on a *South Beach*-branded site

that has so far drawn more than 500,000 subscribers who pay \$19.95 a month—aren't they stick around, on average, for six months. Sites themed around *French Women Don't Get Fat* and the NBC hit *The Biggest Loser* have followed. Next challenge: making that network work with *Men's Health* and *Prevention*. But if enough of the 20 or so subscription sites Murphy promises by '08 succeed, they will more than make up for failures such as *Only Style* (a magazine that ran through four top

editors in four years). “I don't think our size”—revenues not approach \$600 million—“or not being any part of any club held *Women's Health* back,” shrugs Murphy, referring to a magazine he's sweet on. As we all found out, the high school in crowd was wrong about almost everything. ■



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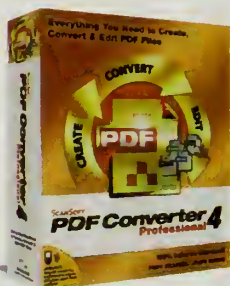
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JAMES C. COOPER

# The Fed Could Go Into Hibernation This Winter

lation worries are easing, and the overall economy is holding up well

**U.S. ECONOMY** If you're keeping a close eye on the Federal Reserve, you're probably in one of two camps: those who think the Fed's next move in the coming months will be a resumption of interest rate hikes, or those who believe it will begin to cut rates. Folks in the first group think the economy is generally strong and inflation won't

side. The other bunch believes inflation worries are blown, since the economy is weakening ultimately to a point where lower rates will be needed to prop it up. Investors, who just want to know where to put their money, are caught in the middle as the markets hem and haw over the uncertainty about where policy is headed. However, recent developments in several areas, especially energy prices, now suggest a third possibility, that could be a boon for both stocks and bonds: The Fed might be content to sit on the sidelines for a very long time. There was nothing to dispute that notion after the Sept. 20 meeting, when the Fed decided to leave its target rate on hold, at 5.25%, for the second time in a row. In balance, the trends in inflation and economic growth appear to be closely tracking the favorable expectations the Fed laid out in its June forecast.

Based on the Fed's statement, policymakers still think the risks associated with attaining its desired paths for growth and inflation are slanted slightly toward the risk of more inflation. However, they also believe price pressures "seem likely to moderate over time," with lower energy prices helping toward that end. The latest economic reports tend to agree. They indicate not only that inflation is looking a bit tamer than earlier in the year but also that growth in the second half is holding up well, especially consumer spending amid the ongoing weakness in housing. As long as those patterns continue, the Fed has no reason to jump into the ball game.

**NEWEST DEVELOPMENT** helping to keep the Fed on hold is the drop in oil prices, which is a win-win situation for both economic growth and inflation. The Fed has been concerned that higher costs for energy and other commodities could fuel inflation as businesses try to pass along those increases to prices broadly. It has also worried about costlier energy, along with weaker housing and higher interest rates, could stifle economic growth. Now, crude prices have dropped 19% from their mid-year peak of \$77 per barrel, and wholesale gasoline prices have plunged 35% since early August, a decline that would translate fully into pump prices (chart). Those developments are easing inflation worries in addition to

boosting the purchasing power of consumers. The lift could be substantial—and well-timed for the holiday buying season. The National Retail Federation is already predicting a solid 5% gain in holiday sales vs. 2005.

Costlier energy acted like a tax hike on consumer incomes, but now households are getting a "tax cut." Based on a back-of-the-envelope estimate, a 20% drop in gas prices from the third quarter to the fourth quarter could free up some \$65 billion in households' aftertax income, which could be either spent or saved. If only half of that money were spent, it would add almost 1.5 percentage points to the fourth quarter's increase in real consumer spending, measured at an annual

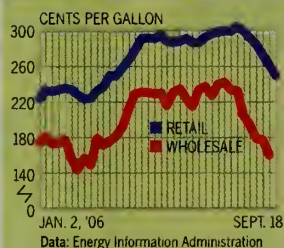
rate. A stimulus of that size could lift the quarter's overall economic growth by about one full percentage point.

It also would provide a sizable offset to the downdraft from weaker housing activity. Housing starts declined 6% further in August, to an annual rate of 1.67 million, the lowest level since April, 2003. Builders' assessments of the housing market in early September, as gauged by the National Association of Home Builders, slipped to a level last seen in the 1990-91 recession.

**DESPITE WORRIES** about a wider impact of the housing downturn, consumers continue to show life in the third quarter. Outlays for both goods and services, adjusted for inflation, began the quarter with the largest monthly increase of the year, and the key components of the August retail sales data that go into the government's measure of overall consumer spending showed another healthy advance. In fact, household buying is set to make a larger contribution to economic growth this quarter than it did last quarter.

Through the second quarter, newly updated numbers from the Federal Reserve show few signs that household

## GAS PRICES: DOWN AND HEADED STILL LOWER





wealth is suffering as a result of the weakness in home prices. Overall net worth last quarter hit a record, but it increased by only \$54 billion, the smallest gain in almost four years. However, the slim rise was due mainly to a drop in financial assets, partly reflecting the stock market's lousy performance last quarter. Homeowners' equity, the net of real estate values minus home mortgages, continued upward, although at a slower pace. The stock market has since turned around, which should give a strong boost to third-quarter net worth.

**LOWER ENERGY PRICES** will also help businesses to cope. Companies are showing some strain from this year's runup in energy costs and higher interest rates, according to the Business Roundtable's latest survey of top executives at U.S. corporations. The Roundtable's fall canvass shows CEOs expect a slower pace for sales, capital spending, and hiring in the coming six months.

The survey results also illustrate the Fed's concerns about the pass-through of higher energy costs into final prices. In response to a special question, 54% of the CEOs said they were either "mainly able" or "partially able" to pass along these increases. However, the energy price drop will help to ease some of those inflation worries.

Even with the big energy declines yet to show up in the overall price indexes, the core indexes, which exclude energy and food, are already starting to move in the Fed's direction. After posting worrisome monthly increases of 0.3% for four months in a row, core consumer prices rose only 0.2% in both July and August. Core producer prices

for finished goods looked even better: They fell 0.3% in July and 0.4% in August. Those drops reflected discounts for cars and trucks, but even excluding the discounts, core prices were tamer than they were earlier in the year.

Perhaps more important to the Fed, cheaper oil and gas are helping to sedate inflation expectations, the containment of which policymakers see as a crucial part of their strategy. Between the Fed's Aug. 8 and Sept. meetings, the expected inflation rate implied in the financial markets by the spread between a 1 year Treasury note and 10-year Treasury Inflation-Protected Security fell from 2.66% to 2.42%, the lowest reading for this measure since January (chart).

Right now there are two main threats to the Fed's status quo policy. For inflation, the recent surge in unit labor costs could add fuel to companies' efforts to raise prices. As for growth, the housing slump's dimensions and repercussions are still unknown. But cheaper energy should help on both of those fronts, lending support to the Fed's objective of sustainable, noninflationary growth. That's a scenario investors of all stripes would be happy with. ■

## A RENEWED DECLINE IN INFLATION EXPECTATIONS



## EXPORTS

# Capital-Goods Companies Catch the Wave

**MAKERS OF** capital goods are taking advantage of some favorable market conditions. A sustained period of strong demand abroad for machines, computers, and other equipment, along with a softening dollar, are allowing capital-goods exporters to raise prices. In August, export prices of capital goods increased by 0.5% from a year ago. It was the largest gain in over a year after prices fell during the later half of 2005 and through the first quarter of this year.

Not so long ago producers "showed a preference for gaining market share," says U.S. economist Brian Bethune at Global Insight Inc. There was a lot of spare capacity, so capital-goods makers kept dollar-

denominated prices steady as the greenback began its slide—starting in mid-2004—in an effort to become more competitive. Now that capacity utilization is above its long-run average, producers feel more confident about raising prices in order to offset higher production costs and maintain their profit margins, says Bethune.

The resurgence of U.S. exports is

being led by capital equipment as overseas business investment improves, particularly in the euro zone and in Japan. Exports of all goods and services through July have expanded by 12% vs. the same period in 2005, with capital-goods exports accounting for a

disproportionate 35% of that gain.

Demand for U.S. capital goods should remain healthy. On Sept. 14, the International Monetary Fund raised its global economic growth estimates. The IMF now expects economic growth to clock in at 4.9% next year, on top of a forecasted gain of 5.1% this year.

That puts capital-goods makers in a position to benefit from any further weakening in the U.S. dollar. The dollar has already fallen 5% against a basket of major currencies this year. If the Federal Reserve stands pat, other major central banks gradually raise rates over the rest of the year, the greenback is likely to face further downward pressure. Any signs of easing geopolitical tension would most likely lead to a softer dollar; well, since increased global certainty reduces the attractiveness of U.S. assets as safe-harbor investments.

—By James Mehring in New

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# The Business Week

## News you need to know

EDITED BY HARRY MAURER



**Housing Cracks** A pneumatic hammer couldn't nail homebuilders any worse. Customers who once mobbed their open houses are suddenly scarce, and inventories of unsold homes are piling up—so builders are sawing off construction. On Sept. 19 the **Commerce Dept.** reported that starts on new homes fell 6% in August from July to a seasonally adjusted annual rate of 1.67 million. The decline was about twice as big as economists had predicted.

It's probably not the bottom, either. A day earlier the **National Association of Home Builders** announced that its market index for September, based on a survey of members, had fallen for an eighth straight month to its lowest level since February, 1991. The mounting pessimism indicates that builders are likely to cut back even more in the months ahead. So far, Wall Street seems to be taking it in stride.

See "Stocks can handle the housing chill," page 34

**The Fed Stands Pat** Buoyed by cheery news on both the inflation and growth fronts, **Ben Bernanke** and the other Fed policymakers on Sept. 20 decided to leave their benchmark rate at 5.25% for the second meeting in a row, and there's reason to think they may sit tight for a good while.

See "The Fed could go into hibernation this winter," page 23

**Incredible Shrinking Detroit** Good grief, **Chrysler** too? For the past year, many observers thought Chrysler had evaded the red ink and downsizing moves afflicting **GM** and **Ford**. But on Sept. 15, **DaimlerChrysler's** unit said it will lose \$1.5 billion in the third quarter because of slow truck sales, health-care costs, and pricey commodities. The com-

pany chopped production by 16% for the second half of the year and may eventually turn to permanent job and output cuts. On the same day, Ford unveiled a more drastic re-plan than it had described in January. It will close 10 more factories—bringing the list slated for shuttering to nine—speed buyouts for 30,000 factory workers, and slash 14,000 white-collar jobs. It also said it had held talks with GM about an alliance but that the idea went nowhere.

See "Does Ford deserve all the Street's heat?" page 20  
**ONLINE** "Turnaround time at Chrysler—again?" "No shot at wedding for Ford and GM," and "How do you save a company?" [www.businessweek.com/go/t](http://www.businessweek.com/go/t)

**HP's Sleuths** In early September, **Hewlett-Packard** shocked Silicon Valley to Wall Street with news that it had spied on its own directors and staff in efforts to track down news leaks. Turns out that was just for starters. **Gumshoes** answering to **Chairman Patricia Dunn** and **General Counsel Ann Baskins** also tailed board members, installed spyware on a reporter's computer, surreptitiously obtained information on some 240 phone accounts of employee directors, reporters, and their families, and even mulled infiltrating newsrooms. Dunn, Baskins, and outside counsel **Larry Sonsini** will testify before Congress on Sept. 28.

See "Sonsini under scrutiny," page 20

**Big Bucks for Freescale** As CEO of **Motorola** spins **Freescale Semiconductor**, **Michel Mayer** created remarkable value out of a money-losing chipmaker that seemed perennial also-ran. On Sept. 15 a group headed by **Blackstone Group** agreed to pay \$17.6 billion, a mammoth 30% premium, to take Freescale private. They're betting Mayer can squeeze still more juice out of products that constitute the smarts in everything from cell phones to cars—and acquisitions to create a tech power. Can Mayer-the-turnaround-guy become Mayer-the-magician?

**Executive Suite** Results have been plug-ugly at cosmetics maker **Revlon** this year—and last year, and the one before that. So few were surprised on Sept. 18, when **Revlon** said **CEO Jack Stahl** would step down to "pursue other interests." Stahl joined the already struggling company 10 years ago from **Coca-Cola**, where he won a sweet reputation as a brand manager. But his efforts to beautify Revlon, which is controlled by **Chairman Ronald Perelman**, flopped. His successor, the fourth CEO in seven years, is former **David Kennedy**. Elsewhere, on Sept. 20 insurer **AIG** said one of the most respected names in banking, **Robert Williams**, would take the helm as chairman in November.

**Amaranth's Big Hurt** Sometimes hedge funds are too swift at hedging. Connecticut giant **Amaranth Advisors** on Sept. 18 revealed losses of more than half its \$9 billion in assets on disastrous bets in the natural gas market. The fund, founded by **Nicholas Maounis**, bought contracts expecting prices would rebound from recent lows. But with a mild hurricane season and ample supplies, the rebound never came, shooting Amaranth's portfolio full of holes.



ce the losses were confined to one niche in the energy  
, broader markets stayed cool.

**ortal Problems** Yahoo! drew a chorus of boos from in-  
ors on Sept. 19 after **CEO Terry Semel** said slowing ad  
s could whack third-quarter results. It's the third time  
year the Internet portal has announced setbacks. This  
sent shares plummeting 11%, to \$25.75. Yahoo said the  
rit was mainly auto and financial-services advertising.  
See "Click fraud," page 46

**Garde, Sony and Microsoft** Got game? Nintendo  
is to have plenty of them for the Nov. 19 debut of its **Wii**  
-generation console. Rival Sony expects its **PlayStation 3**  
e in short supply when it launches on Nov. 17, but Nin-  
lo execs say they'll have lots—plus nearly three dozen  
es and the ability to download games of yore. And Wii  
be priced to move, at \$250, half the cost of the cheapest  
y system and well below Microsoft's \$400 **Xbox 360**.

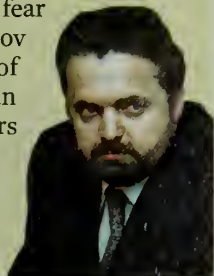
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**lone Wants to Fly** Billionaire dealmaker and one-  
e cable mogul **John Malone** never met a tax break he  
n't love. With the potential to save \$3 billion in capital  
is under the arcane **IRS** "cash-rich asset" rule, Malone  
egotiating to swap his 19% stake in **News Corp.** for that  
pany's 38% stake in satellite TV operator **DirecTV**. No  
ter that the satellite biz has been losing altitude to ca-  
of late. Malone likes DirecTV's cash flow that will en-  
him to—what else?—add debt to do more deals.

## Outrage of the Week

**drei Kozlov**, deputy chairman of the Russian central  
ak, had just finished playing soccer on Sept. 13. Leav-  
g the stadium, he and his driver were met by two men  
o gunned them down, a reminder that Russia can still  
a nasty and dangerous place. The murder, probably a  
ntract killing, raises serious questions about Russia's  
lity to tackle business-related violence and to perse-  
e with reforms to its murky banking industry. Kozlov  
oto) had spearheaded a campaign to clean up the  
tor, yanking the licenses of dozens of banks suspect-  
of unsound or illegal activities. The message sent by  
killers to regulators: Continue at your peril. **President**  
**dimir Putin** has vowed to press on with the crackdown  
d has ordered senior police officers to cooperate with  
ntal bank officials. But skeptics fear  
t whoever arranged the hit on Kozlov  
y never be caught. The killers of  
bes's **Paul Klebnikov**, an American  
rnalist shot in Moscow two years  
o, have not been found.

**ONLINE** See "Top Russian banker  
assassinated,"  
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## SILICON VALLEY

# SONSINI UNDER SCRUTINY

Superlawyer Larry Sonsini has ties to the HP scandal and the mess over backdated options. Are his fingers in too many pies?

**BY PETER BURROWS AND ROBERT D. HOF**

**L**ARRY W. SONSINI HAS ALWAYS been Mr. Untouchable in Silicon Valley. While luminary clients such as Steve Jobs, Carly Fiorina, Marc Andreessen, and Scott McNealy have all had their messy ups and downs, Sonsini's star has always shone with a steady glow. And the publicity-shy superlawyer has been a genius at steering clear of controversy. Says one Valley leader who has worked with him for many years: "Larry is Teflon."

Until now. Sonsini has been nicked by his involvement in HP-Gate, the possibly illegal investigation into home phone records at Hewlett-Packard Co. While he evidently knew nothing of the probe before it was completed, Sonsini later told one outraged board member that "pretexting"—impersonating a person to get access to their phone records—was "within legal limits." That's drawn a chorus of boos from privacy experts. The criticism only grew louder when the news broke that Sonsini helped run an HP board meeting on how to manage the pretexting scandal, notwithstanding his earlier role in the affair.

**Editor's note:** Co-author Peter Burrows is one of the reporters whose private phone records were sought by investigators for Hewlett-Packard.

The scrutiny of the 65-year-old attorney is likely to grow only more intense. Separate from the HP imbroglio, the law firm he leads, Palo Alto-based Wilson Sonsini Goodrich & Rosati, represented about half of the 32 Silicon Valley companies now being investigated for possible options accounting violations. And Sonsini was on the board of one of those clients, Brocade Communications Systems Inc., which used to be run by Gregory L. Reyes, the first CEO to be criminally indicted for backdating options. Reyes told *BusinessWeek* earlier this year that Sonsini O.K.'d the unorthodox compensation system that got him into the legal mess—one that gave Reyes the power to grant options at his sole discretion. (A Sonsini spokeswoman contests this account.)

While the HP and backdating scandals differ in important ways, they both raise unexpected questions about Sonsini's judgment. Why didn't he sound alarms when he first found out about pretexting? Why didn't he recuse himself from the board's deliberations about the scandal? Shouldn't his firm's lawyers have noticed the widespread sloppiness, if not fraud, in the way options were doled

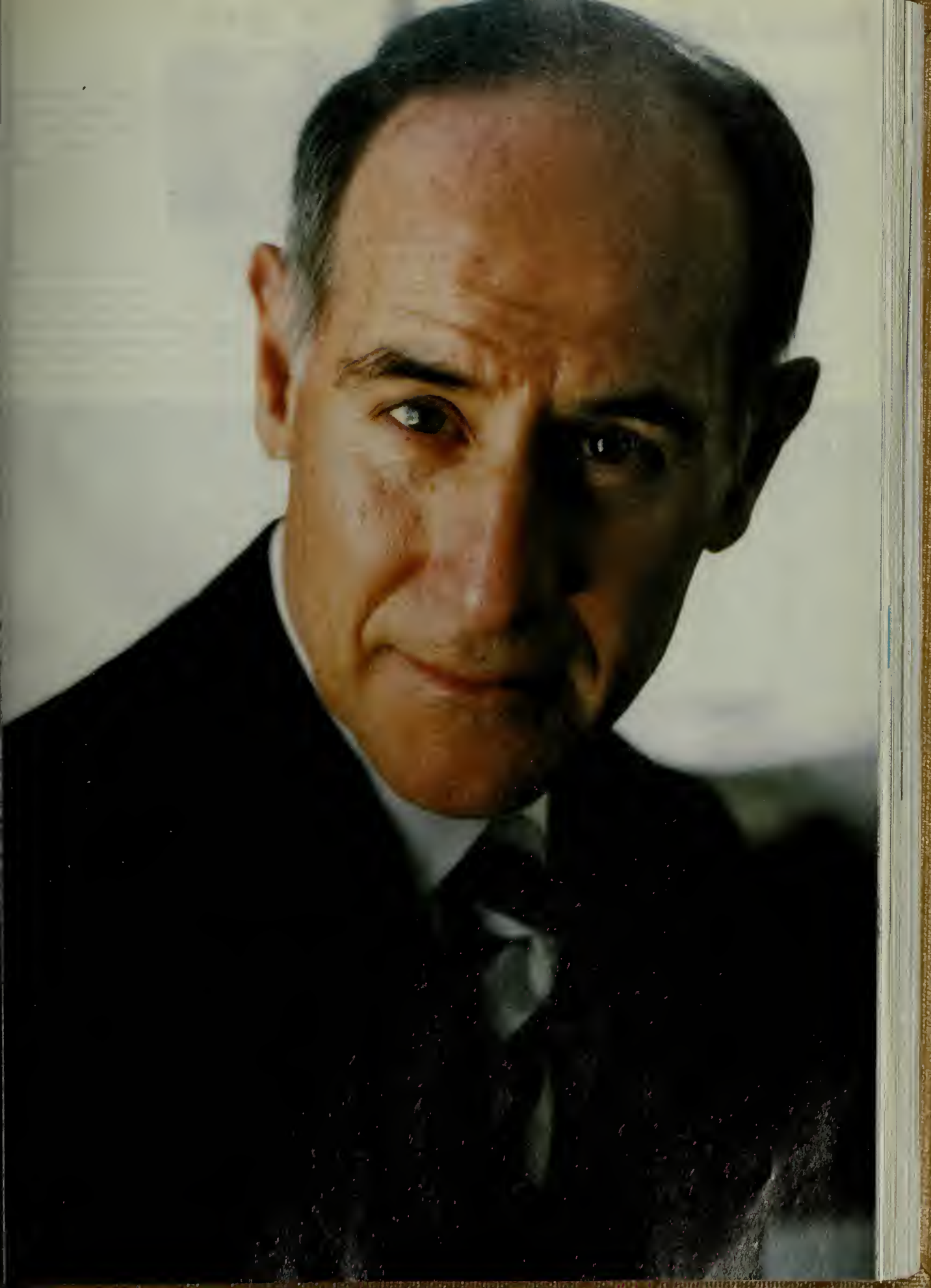
out? The issue is not whether pretexting or backdating is illegal. It is whether Sonsini was giving his clients the most sensible advice.

Sonsini is under especially intense scrutiny because he is, without a doubt, the most important lawyer in Silicon Valley. Soon after arriving there a young attorney four decades ago, he cultivated the technology companies that were sprouting in the shadow of Stanford University and picked up an un-

valued roster of clients, including Advanced Micro Devices, Seagate Technology, Sun Microsystems, multiple venture capital firms, and every investment bank that mattered in the digital world. He took Apple Computer Corp. public in 1980 and Google Inc. public in 2004.

As Wilson Sonsini got its lawyers fanned out, it took top positions at tech companies. Larry Sonsini's word became virtually unassailable in the rich kingdom situated between San Francisco and San Jose. "Everyone in Silicon Valley has a speed dial to Larry whenever they have a sticky problem," says Sun Chairman Scott G. McNealy, who incorporated the company in 1982.

**McNealy:  
'Everyone  
in Silicon  
Valley has  
a speed dial  
to Larry'**





son Sonsini's office in 1982.

Such loyalty is a tribute to Sonsini's lawyering skills. Clients rave that he is knowledgeable about the law, available at all hours, cool under pressure, and brilliant about the tech industry. He's so good and so well-connected, in fact, that over the years he has become much more than a typical corporate counselor. Customers rely on Sonsini as a strategic adviser, governance expert, and dealmaker.

And, critics contend, that's where the problems start. He often finds himself wearing multiple hats and trying to navigate between clients with conflicting agendas. In a post-Enron age, corporate watchdogs argue that Sonsini's and the Valley's

cozy practices, while legal, may no longer pass the smell test. Looking beyond the HP and options brouhahas, Sonsini and his law firm have a history of doing deals and investing in clients in ways that some find troubling. "Sonsini is a symptom of an incestuous governance culture," says Ralph D. Ward, publisher of the online newsletter *Boardroom Insider*. "Everybody is in bed with each other. It clashes very much with the Sarbanes-Oxley environment."

Perhaps, but it's worth noting that



**BASKINS** The HP general counsel's husband works for Sonsini's law firm

Sonsini's clients have historically performed exceptionally well financially. Wilson Sonsini spokeswoman Courtney Dorman denied that Sonsini or any of his partners have handed out illegal or unethical advice. "The job of a lawyer is to protect the interests of his or her client. If that means taking so much criticism in the press, that's part of the job," she says.

The HP drama provides ample evidence of how complicated life can be for her. The company has long turned to Sonsini

## Counselor To The **Kings** Of Tech

Larry Sonsini's connections to the Silicon Valley elite run deep. When *BusinessWeek* photographed the Valley's most powerful leaders in 1997, he was the only lawyer pictured.

### LARRY ELLISON

Not a Sonsini client.

### MARC ANDREESSEN

Sonsini's firm took Netscape public, and a Wilson Sonsini lawyer led the browser maker's epic battle against Microsoft in the late 1990s.

### ANDY GROVE/GORDON MOORE

Intel is one of few companies where Sonsini's firm has had little presence over the years. But the firm does represent Intel rival Advanced Micro Devices in its suit against the chip giant.

### STEVE JOBS

Sonsini handled Apple's IPO in 1980. Jobs later put him on the board of Pixar Animation, which is embroiled in the stock options scandal for allegedly giving grants at yearly stock lows.

### SCOTT McNEALY

Sonsini advised Sun through its IPO and many later ups and downs.

### JOHN DOERR

Sonsini's firm has provided legal services to dozens of start-ups funded by Kleiner Perkins Caufield & Byers, where John Doerr is a partner.

### LARRY SONSINI





crucial advice. He counseled former HP CEO Lewis Platt when HP spun off its electronics instruments business in 1999; he helped ex-CEO Carleton S. Fiorina win an proxy battle against Walter Hewlett in 2001; then last year he was in the room when Fiorina was told that she had been fired. What's more, his firm employs the former HP General Counsel Ann O. Perkins, who oversaw the phone records investigation and is now under investigation.

Given all of these close relationships, it's hardly surprising that the board asked Sonsini's assistance steering through the phone pretexting fiasco. But his performance has won few admirers. Companies make mistakes all the time. When

they do, there is a template for cleaning up the messes, which involves thoroughly investigating the problem, firing any wrongdoers, and airing the misconduct before others do it for you. This is the path a strong outside counsel is supposed to recommend—and the one that critics believe Sonsini erred in straying from. Now HP is paying the price with an embarrassing story that won't go away.

Instead of quickly identifying pretexting as a privacy invasion that would offend regulators and the public, Sonsini helped HP circle the wagons. When Director Thomas J. Perkins quit the board in a huff over the methods the company used in its probe and the dismissal of a fellow director, Sonsini was asked to help prepare the Form 8-K required when a board member leaves. Rather than advise HP to issue the version of the form required when there is a major disagreement, he allowed the company to file one that could have led people to believe Perkins simply stepped down for personal reasons.

## BROAD INFLUENCE

IN AN E-MAIL exchange, Sonsini also warned Perkins, a famed venture capitalist and longtime acquaintance, about the dangers of violating a director's duty of confidentiality: "Tom, be careful of your discussions about the inquiry." He later sent a message informing Perkins that pretexting was "not generally unlawful." Next, he helped broker a deal in which nonexecutive board Chairman Patricia C. Dunn agreed to resign her post but stay on as a director. It was a compromise that satisfied few HP critics. Sonsini "could not have been a worse choice" to advise the board, says Yale School of Management professor Jeffrey A. Sonnenfeld.

One of the reasons Sonsini seems so omnipresent in Silicon Valley is that his firm, by its own estimate, represents 50% of the region's tech companies. No other law firm on Wall Street, K Street, or any other street, for that matter, dominates such a huge chunk of such a vital industry. That is certainly one of the reasons why Wilson Sonsini has become so enmeshed in the backdating scandal.

While the precise advice that the firm's lawyers gave clients on options is still unknown, a clearer picture has emerged in the Brocade case. Former CEO Reyes has said that Sonsini, a director of the company, advised other board members in 1999 to make Reyes solely responsible for issuing options, a critical recruiting advantage during the boom.

But it also meant that Reyes was not subject to ordinary controls. At most com-

# The HP Scandal At A Glance

**JAN. 22, 2005:** Then-CEO and Chairman Carly Fiorina dresses down the board after reporters from *The Wall Street Journal* and *BusinessWeek* contact HP with details of a board meeting where directors urged Fiorina to share power.

**FEB. 7, 2005:** Board votes to dismiss Fiorina and later names Mark Hurd CEO and Patty Dunn nonexecutive chairman.

**SPRING, 2005:** Dunn tells HP's legal group to hire outside firms to investigate the boardroom leaks.

## JANUARY, 2006:

Dunn revs up the investigation after a leak to CNET. By March the leaker has been identified as George Keyworth.

**MAY 18:** HP directors remove Keyworth from the 2007 board slate. Director Tom Perkins resigns.

**JUNE 19:** Perkins sends HP outside counsel Larry Sonsini an e-mail questioning the legality of the leak probe.

**JULY 28:** Sonsini responds that investigators used "pretexting," or impersonating a person to obtain their phone records, and says: "It appears...the process...was within legal limits."

**SEPT. 6-7:** HP admits investigators used pretexting to get phone records of directors and nine journalists, including three from *BusinessWeek*. California Attorney General begins investigation.

**SEPT. 8:** *BusinessWeek* reports that the Justice Dept. is investigating HP.

**SEPT. 12:** Sonsini helps broker deal in which Keyworth resigns and Dunn gives up chairmanship to Hurd.

**SEPT. 18-20:** Press reports indicate that HP managers expressed concerns about the legality of HP's probe as it was occurring. Key players, including Dunn and Sonsini, prepare to testify before Congress on Sept. 28.



PATRICIA DUNN

## HUGART

Sonsini was the disk drive king's counsel for many years, but he was also the one who let the former CEO of Seagate know when he had been fired.

## JOHN CHAMBERS

Sonsini hasn't had a major role in Cisco's history. But sources say Cisco dealmakers were uncomfortable with Sonsini's efforts in aborted talks to buy Brocade Communications, where Sonsini was both board member and outside counsel.

## LEW PLATT

Sonsini helped former HP CEO Lew Platt spin off Agilent and was Carly Fiorina's right-hand man in the HP-Compaq merger. Now he's under fire for his role in the press leak investigation.

MARK  
aded  
cape  
ilson  
took

Data: BusinessWeek



panies, options are granted by compensation committees, which operate under detailed rules. Reyes earlier this year told *BusinessWeek* that neither Sonsini nor the other directors provided guidance on how to properly document an options grant, and that his alleged crimes are no more than paperwork miscues. Add it all up, and it appears as if Reyes is laying the groundwork for an "I trusted Larry Sonsini" defense. Dorman points out that lawyers often earn project fees on big mergers, and says the hat Sonsini was wearing in this negotiation was as a Brocade board member.

## TOO MANY HATS?

THE BROCADE CASE could also shine a light on other controversial aspects of Sonsini's legal practice, among them his multiple roles in corporate deals. Consider the many hats that the legendary Valley lawyer wore in the aborted sale of Brocade to Cisco Systems Inc. in 2004. As a member of Brocade's board, he was a corporate insider. As Wilson Sonsini's chair-

man, he was also the most prominent partner at the company's outside counsel. Sonsini was one of former Brocade CEO Reyes's closest personal advisers and a friend of Reyes's father, a longtime chip executive. According to two sources familiar with the talks, he also acted a lot like an investment

banker by seeking a success fee if the deal went through. "You couldn't tell if he was the lawyer for Reyes, the lawyer for the company, a board member, or the investment banker," recalls an individual familiar with the talks. Dorman points out Sonsini broke no legal or ethical rules.

That appears to be true—but other corporate attorneys rarely have to juggle so many opposing interests. Another factor that further complicates Sonsini's professional life is that he and his firm often receive lucrative stock and options grants from clients. One example is the sticky situation that arose when Wilson Sonsini client Pixar Animation Studios Inc. was sold to Walt Disney Co. earlier this year.

The merger agreement banned Pixar from soliciting rival bids from other potential acquirers, requiring investors to accept on faith that Disney had made the best offer. That's open to question, but there's little doubt that it was a great deal for several Pixar directors, including Son-

## SNEAK PEEKS

# Good Timing, Carly

BY PETER BURROWS

Is there any silver lining to the scandal engulfing Hewlett-Packard Co. over its controversial investigation to find press leaks? Only if you're former HP CEO Carleton S. "Carly" Fiorina. This buzz-generating mess is the best PR money

can't buy for her upcoming 366-page memoir, *Tough Choices*. The book dishes dirt on the dysfunctional board that ousted her in February, 2005. Indeed, its first sentence, according to someone who got hold of an early copy, is: "In the end, the board did not have the courage to face me."

Some HP insiders fear the book will fan the flames of scandal. They should worry, says our source. Coming in for criticism in *Tough Choices* are former HP directors Tom Perkins and George A. "Jay" Keyworth, central characters in the leak controversy, as well as former Compaq Computer chief Michael D. Capellas, says this reader. The source, who is outside HP and admittedly not a Fiorina fan, asked not to be named.

Penguin Group (USA) Inc.'s Portfolio imprint, the book's publisher, issued a terse response: "Portfolio has no comment about gossip concerning what is or isn't in *Tough Choices*, or any characterization of what Carly Fiorina will say when her book is released." Fiorina's book publicity campaign, like her personality, will be larger than life. She will be featured on 60

Minutes the evening before the official publication date of Oct. 9. She'll later chat it up on *Good Morning America* and *The Charlie Rose Show*, then embark on a major city publicity tour. *Newsweek* will publish an exclusive excerpt, and daily newspapers that agreed not to publish

ahead of time will run stories on Oct. 10.

But Fiorina is unlikely to change many minds about her own record at HP. While the book begins with a revealing self-portrait—right down to the fact that her childhood role model was Cinnamon Carter, the strong female character on the *Mission: Impossible* TV show—the chapters dealing with HP left our source unimpressed: "The only mistake she admits to is that she trusted the wrong people."

That's not a common view around HP. Even Fiorina fans who credit her with setting the stage for HP's recovery say she lacked the skills of successor Mark V. Hurd, under whom HP's stock has risen 72%. "I don't think she had the skills to be an operating manager, and she was very reluctant to bring someone in who was," says one high-ranking company insider.

A smaller point made by our critic: "She cries a lot in the book. I started keeping track." Unofficial count: seven crying incidents, and one "came close to crying." But with events breaking her way, Carly may be crying all the way to the bank.

—With Steve Hamm in New York



**MORE DIRT ON HP** The former CEO criticizes key directors

sini. Upon consummation of the sale, directors' stock options would immediately vest, allowing them to buy Disney shares at discounts, sell them at market prices, and pocket the difference. Sonsini stood to gain about \$2.4 million, much of which will likely go into a Wilson Sonsini partners' fund should he exercise the options.

According to regulatory filings, the only firm lawyer who gave presentations at Pixar board meetings during the negotiations was Sonsini. It's not clear, however, whether he was speaking as a Pixar director, outside counsel, or both. As outside

lawyer, he was obligated to give his client the Pixar board, unbiased counsel, including opinions it may not have wanted to hear. But given his stake in the merger, could he really have offered such advice?

More accustomed to asking tough questions than answering them, Sonsini will nonetheless find himself on the receiving end of some very tough questions in the state and federal probes of the scandal. First up: a congressional hearing on Sept. 28. ■

—With Justin Hibbard in San Mateo  
Susan Zegel and Michael Orey in New York

## What Sonsini knew and when is still unclear



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## COMMENTARY

BY PETER COY

# Stocks Can Handle the Housing Chill

The numbers are scary. But history shows that the market can shrug them off

**P**LENTY OF EXPERTS think “for sale” signs on Elm Street are bad for stocks on Wall Street. Merrill Lynch & Co. economists say housing is “undeniably in recession” and “the only question left is whether this morphs into a general recession.” That would be a major bummer for Wall Street. Pessimists are citing some scary numbers: The government announced on Sept. 19

that housing starts in August fell 20% from a year earlier, twice the drop economists expected. And in a sign that starts could fall even more, an index of homebuilders’ optimism plunged in September to its lowest level since the banking crisis of 1991.

Don’t panic, though. History shows that the stock market can hold up as long as a housing slowdown doesn’t foreshadow—or cause—a recession. For example, in 1995 builders’ confidence slid sharply. But because the economy merely paused without shrinking, the stock market kept rising. Today, many economists believe that the economy, and Wall Street, will once again shrug off housing’s troubles. “The markets are increasingly compartmentalizing their concerns about housing,” says Michael R. Englund, chief economist of forecaster Action Economics.

Bears worry that a housing downturn will hurt because it accounted for such a big share of economic growth over the past five years. The real estate boom created tons of jobs in construction, sales, lending, and related industries. Plus, it gave consumers billions in extra spending power through cash-out refinancing, home-equity loans, and the like.

But the employment hit in homebuilding is being offset by growth in nonresidential construction. As for the hit to consumption, there’s no sign of it yet, and there may never be much of one. Americans may just continue to spend even though their houses are worth less. A 2005 research paper by economists

Karl E. Case of Wellesley College, John M. Quigley of the University of California at Berkeley, and Robert J. Shiller of Yale University concludes that while increases in housing wealth spur consumer spending, surprisingly, “declines in housing market wealth have no effect at all upon consumption.”

The Federal Reserve knows housing could trash the economy, so at its Sept. 20 meeting it left interest rates unchanged. The Fed may even start cutting rates soon, which would be a big plus for the stock market.

Investors are betting Wall Street will emerge from the housing slowdown unscathed: The Standard & Poor’s 500-stock index is near a five-year high, having risen 8% since June, while

**The S&P is near a five-year high, and the Fed could start cutting rates**

the news on housing has gotten steadily worse. Even homebuilder stocks have been rebounding lately. Since their lows in early September, Pulte Homes and D.R. Horton are up 12%, while Lennar and Centex are both up 7%.

Nothing is certain in the stock market, of course. “Right now, most investors are assuming that [Fed Chairman Ben] Bernanke is going to pull off a soft landing,” says Alfred Goldman, chief market strategist for A.G. Edwards & Sons

Inc. “If the housing market gets washed out big time, the odds of a hard landing and a recession go up substantially.” In that case, says Goldman, stocks will surely suffer. True enough. Right now, it looks like investors have a fighting chance to make up in their stock portfolios at least a little of what they lose on their homes. ■

**BusinessWeek weekend**

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## MORTGAGE MARKETS

# BAD BLOOD OVER BAD LOANS

Mortgage defaults are rising. Wall Street  
winks banks should mop up the mess

MARA DER HOVANESIAN

EVERYONE INVOLVED IN the mortgage business got rich during the housing boom, including Wall Street. The biggest firms bought all the loans they could get their hands on, packaged them, and sold them for a fee

edge funds and other investors. Mortgage-backed securities issuance soared to \$184.5 billion in 2000 and nearly \$1 trillion in 2005, generating more than \$1 billion in fees last year.

But now that the real estate tide is ebbing, trash is washing up on shore. Mortgage delinquencies are rising—bad news for the banks, Wall Street firms, and investors holding loans.

In some cases, the originators are taking the biggest hits. In typical deals, banks agree to buy mortgages back from Wall Street in the case of a payment default within the first 90 days. Now some are paying big checks. H&R Block Inc., owner of Option Mortgage Corp., repaid a fiscal 2007 first-quarter loss of \$219 million to set aside cash for buybacks. Defaults forced NetScout Inc. and Fremont General Corp. to buy back thousands of loans as well. Fremont paid \$238.4 million in the second quarter, up from \$57 million a year earlier. But Wall Street is feeling

the sting, too. A few lenders have refused to buy back loans, prompting arbitrations and lawsuits. Bear, Stearns & Co.'s mortgage affiliate, EMC Mortgage Corp. of Irving, Tex., is suing New York lender MortgageIT over \$70.5 million in disputed buybacks. (Deutsche Bank said in July it would buy MortgageIT Holdings Inc. for \$429 million; it declined to com-

ment.) And Lehman Brothers Inc. is trying to recoup \$20 million on toxic loans bought years ago from Beverly Hills Estates Funding Inc., whose principal, Charles Elliott Fitzgerald, is believed to have fled the country to a South Pacific island. "While the speculation is that he's offshore, we don't have any leads to his whereabouts," says Michael Wachtell, an attorney for the receiver overseeing Beverly Hills Estates Funding's liquidation.

## SMALL-SHOP WIPEOUT

THE LOSSES COULD get much worse. Precise estimates are hard to come by, but D. Keith Johnson, chief operating officer of Clayton Holdings Inc., a loan-risk analysis outfit, says his firm alone has evaluated some \$3 billion in potential buyback transactions this year. There's no telling how much of that will go sour. Smaller shops that feasted on shaky loans during the boom could be wiped out. "They popped up like mushrooms after a rainstorm," says Michael Robert Cavendish, an attorney at Boyd & Jenerette in Jacksonville, Fla., a firm that has won some arbitrations recently.

"But many are undercapitalized." Analysts say buybacks were a major factor in the collapses of Acoustic Home Loans, an affiliate of California lender Metrocities Mortgage, and Texas-based QuoteMeARate.com. Metrocities declined to comment. QuoteMeARate.com's Web site and phone number are no longer in service.

Wall Street's latest strategy: Improve quality control by acquiring lenders. On Sept. 5, Merrill Lynch said it would pay National City \$1.3 billion for its First Franklin Financial Corp. unit. On Aug. 9, Morgan Stanley said it had agreed to buy Saxon Capital Inc. in Glen Allen, Va., for \$706 million. Analyst David A. Hendler of New York bond research shop CreditSights says New Century Financial, KKR Financial, American Home Mortgage, and a handful of other lenders could soon come on the block. Deals made now will leave buyers with plenty of time to clean house before the next real estate boom. ■

—With Dawn Kopecki in Washington



## Right Back At Ya

Now that some of the riskiest mortgages are defaulting, Wall Street wants its money back. It's demanding that mortgage lenders buy back bum loans. Banks face grim choices.

| MORTGAGE OUTFIT                                         | CONSEQUENCE OF REPURCHASE CONTRACT                                                                     |
|---------------------------------------------------------|--------------------------------------------------------------------------------------------------------|
| <b>MortgageIT Holdings</b><br>New York                  | Sold off a big slug of loans to Bear Stearns; now Bear is suing to force a buyback                     |
| <b>Acoustic Home Loans</b><br>Orange, Calif.            | Went out of business in April when buyers of its bad debt demanded repayment                           |
| <b>H&amp;R Block</b><br>Kansas City, Mo.                | Boosted loss provisions by \$102 million in fiscal first quarter in case it's forced to take bad loans |
| <b>Impac Mortgage Holdings</b><br>Newport Beach, Calif. | Repurchased loans sold for \$100 million at an \$18 million loss in the second quarter                 |

Data: BusinessWeek, UBS Investment Research



DETROIT BLUES

# DOES FORD DESERVE ALL THE STREET'S HEAT?

## Why it's waffling on what lies ahead for its money-losing luxury brands

BY DAVID KILEY

**F**ORD MOTOR CO., STRUGGLING to convince Wall Street that its third try at restructuring in five years will be the charm, is winning over few believers with its stepped-up plan, announced Sept. 15, to buy out thousands of workers and close plants. That's in part because the automaker is still noncommittal about selling or shuttering troubled and bleeding luxury brands such as Lincoln, Jaguar, and Land Rover. Ford's share price dropped nearly 12% the day of the announcement, while analysts like John Murphy of Merrill Lynch & Co. quickly downgraded Ford from neutral to sell. The latest plan, Murphy says, is "missing a lot."

Is the Street overlooking something here? Maybe. Inside Ford a spirited debate is under way over the luxury question. Some executives continue to cling to a sprig of hope that Lincoln can be saved. That may be wishful thinking. But the reluctance to part with Jaguar and Land Rover starts to make more sense if Ford can use them as the basis of a potential alliance with Renault-Nissan. And that might help explain why, despite the fact that Jag lost \$1 billion last year and will again this year, the vice-president of Ford International, Mark A. Schultz, is adamant about hanging onto the brand. "Jaguar is not for sale now," he says.

After pouring some \$20 billion into its

luxury brands, Ford executives are understandably loath to shutter them or sell them only to watch a rival make them successful. Still, why hang onto Lincoln? Because there is some support inside Ford for combining Lincoln's retail distribution and some engineering and manufacturing with Ford's Volvo brand, while killing long-suffering Mercury. Ford optimists believe that the combo could draw a younger mix of traditional American and

import buyers to both brands. And plans have been afoot for years to build Volvos in the U.S. and share engineering with Ford and Lincoln models. The platform of the Volvo S80 sedan and XC90 SUV underpins the forthcoming Ford Fairlane crossover, as well as a secret Lincoln "people-mover" that will likely be made public in January. As always at Ford, a Lincoln-

### Upscale Letdown

Ford has five luxury brands to Toyota's one but sells fewer cars

(U.S. retail vehicle sales in 2005)

TOYOTA: LEXUS  
**303,000**

FORD: LINCOLN, LAND ROVER,  
JAGUAR, VOLVO, ASTON MARTIN  
**291,000**

BMW  
**266,000**

Data: Autodata Ltd.



Volvo tie-up will rise or fall on execution

Then there are the British brands. Executives who have recently left Ford and Nissan point to Carlos Ghosn's gaping luxury hole at both Nissan and Renault, where he is CEO. Nissan's Infiniti brand sold just 150,000 vehicles worldwide last year, 9% in the U.S. Renault has no luxury business. Ford's Jaguar and Land Rover are both true global brands. Ghosn, like any automaker, lusts after luxury profit margins that can top 15%, if managed right, vs. around 5% to 6% at best for mass-market vehicles.

### GOING FOR GHOSN

A FORD EXECUTIVE who asked not to be identified argues that Ghosn is better situated politically to stop building Jaguars and Land Rovers in high-cost British factories. That's because Ghosn has already moved Nissan production to an ultra-efficient nongovernment plant there and likely could do the same with Jaguar and Land Rover. Tying up with Nissan-Renault also could help Ford boost the popularity of both British makes in Europe and Asia, where they have solid brand awareness and room to grow. "Half the earnings from a viable business in Ghosn's hands would benefit both companies and be the ideal start of a fuller alliance down the road," says the Ford executive.

Ghosn says for now there is nothing doing with Ford, either an alliance or a deal to buy its luxury brands. But he doesn't rule anything out and is expected to meet with Ford Chairman William Ford Jr. and new CEO Alan R. Mulally as early as next month after he concludes talks with General Motors about a possible, though unlikely, alliance. "Before taking that seriously, we'd have to sit down and really talk about it," says Ghosn. Ford has an attentive audience at Ford.

—With David W.

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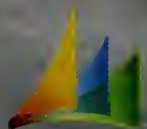
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A man in a light blue button-down shirt and dark blue trousers is operating a blue pallet jack in a warehouse. He is pushing the jack down a long aisle between tall metal shelving units filled with cardboard boxes. The scene is dimly lit, with bright light reflecting off the floor and the boxes in the distance, creating a sense of depth and activity.

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## SOFTWARE

# LINUX SPREADS ITS WINGS IN INDIA

Windows is still No. 1, but open-source software is moving into schools and government offices

BY NANDINI LAKSHMAN

**W**ITH 4,000 STUDENTS and just 21 computers, the Cotton Hill Girls High School in the south Indian city of Trivandrum wouldn't appear to be at the vanguard of anything related to information technology. Yet the 71-year-old school is abandoning Microsoft Windows software in favor of its free, open-source rival, Linux. So when students—typically eight to a machine, seated at two benches—turn on their PCs they see Linux desktop software that helps them navigate their way to all manner of math, graphics, and writing programs. “We’re using something called Linux,” says 12-year-old Arya VM as she plays with Tux Paint, a Linux drawing and painting application. And Windows? “Never heard of it,” she says.

The school is one of 2,600 in the state of Kerala making the shift. That means each of the state’s 1.5 million high school students will grow accustomed to working not in the Windows environment familiar to computer users worldwide, but in Linux. And over the next two years, computer science based on Linux software will be made mandatory in all of the state’s high schools. “As a government that keeps the interest of society over corporations, we are committed to the use and development of free software,” says V.S. Achutanandan, Kerala’s sarong-clad chief minister.

India is shaping up to be a key battleground in the global assault of Linux. The country’s long history of snarling at cor-

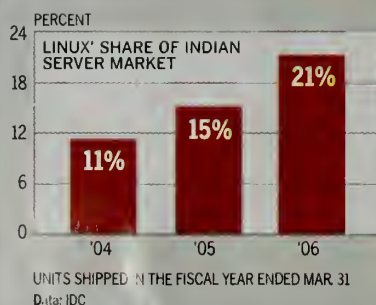
porate interests, its widespread poverty, and its nascent PC culture make it fertile territory for the communitarian ethic of the upstart computer operating system. Two years ago, New Delhi said the best way to improve computer literacy in India was to adopt open source software in schools. Although Kerala is the first to introduce such a program statewide, 18 of India’s 28 states either are using Linux or have pilot projects for its use in various government departments and schools. The education ministries in most states, and in Delhi the federal ministries of defense, transport, communication, and health, are all using the software on server computers. And eight state governments have put their treasury operations on Linux, while the western state of Maharashtra is using it to revamp health-care systems. India “is one of the key countries I have been focused on,” says Scott Handy, IBM’s global Linux boss. “India has been a star.”

That’s not to say Linux will be knock-

ing Windows off the desktop anytime soon. So far, most of its progress has been in server software, programs that government agencies and businesses use for their Web sites, payroll, and other key tasks. In June, Microsoft Corp. had 68% of the server market, vs. Linux’ 21%, compared with 70% for Microsoft and 11% for Linux two years ago. The desktop is a different story: Just 3% of India’s PCs use Linux. Still, that’s about triple the level in the U.S. “We expect India to be the first country to use Linux extensively over a large user base across many sectors by the end of the decade,” says Deepak Phatak, an open-source evangelist from Bombay’s famed Indian Institute of Technology. Two years ago, he took a yearlong sabbatical to travel across the subcontinent to make a push for Linux.

Unlike proprietary software companies such as Microsoft, Linux based on an open-source model. That means its code is available to developers worldwide, who can tweak it to make better or adapt it to their own needs. Since the software itself is often given away for free, revenue numbers for Linux don’t add up to much. Researcher IDC estimates that the Indian Linux market will grow by 21% annually, to \$19.9 million in 2010, mostly for services provided

## PENGUIN RISING





panies such as Red Hat, IBM, and  
Is like Wipro and Tata Consultancy  
ices. That's a modest amount com-  
ed with Microsoft's Indian sales of  
ely \$200 million last year. But Mi-  
oft's lost opportunity is still sub-  
tial, since it sells Windows at \$50 or  
e per copy to makers of PCs and  
ers, and then it typically sells other  
grams that run on top of it. And if  
ents in the emerging tech power-  
se never get any experience with  
dows, the damage a decade from  
o could be far greater.

The shift in government has spurred  
more businesses to use Linux, too. One  
convert is state-owned Life Insurance  
Corp. of India, which in 2005 switched its  
servers to Linux. With the \$2 million in  
savings from using the free software, LIC  
is adding more computers. Today it has  
70,000 PCs, all running Linux, and by  
next year it expects to have more than  
100,000. Others are taking a more mea-  
sured approach. Eighteen months ago,  
when Bombay-based Unit Trust of India  
wanted to set up a call center, the bank  
settled on Linux for its servers even as it

## Microsoft plans to offer India- specific products

continues to use  
Windows on its  
PCs. "The openness  
of the system ap-  
pealed to us," says  
UTI President V.K.  
Ramani. Now, he  
says, the bank is  
putting its credit-  
card system on Lin-  
ux as well.

Microsoft is  
fighting back. The  
company has been working on India-spe-  
cific products at its development center in  
the southern city of Hyderabad. One of  
them is Windows XP Starter Edition, a  
scaled-down version that can only open  
three programs at once and doesn't sup-  
port advanced networking. But it sells for  
just over \$20, or less than half the price of  
the original. And unlike the full Windows  
it comes in 10 Indian languages rather  
than just English and Hindi. While "it's  
too early to say" whether Linux has hurt  
sales, "we are concerned" about its rise,  
says Radhesh Balakrishnan, Microsoft's  
director of platform strategy for India,  
who moved from the U.S. in July. "We  
need to demonstrate superior value to our  
customers," he says.

### SERVICE TROUBLE

LINUX, MEANWHILE, is having some  
growing pains. One issue that has slowed  
its spread is counterfeiting. Since software  
is widely pirated in India, many users pay  
nothing for the Windows operating system  
and other Microsoft applications that they  
use. Also, since Linux is distributed free,  
it's not always obvious whom to call for  
service. Companies such as Red Hat and  
IBM support the software—for a fee—but  
they're having trouble finding Linux-  
trained engineers in India.

Those issues have led some companies  
to abandon Linux. For instance, North  
Delhi Power Ltd. started using Linux  
both in its servers and on the desktop in  
2002. But the Linux e-mail program it  
was using, Sendmail, never quite worked  
right. The company soon switched to  
Windows and Microsoft's Exchange e-  
mail server, and it has no plans to go  
back. "There were immense mainte-  
nance, service, and upgrade issues," says  
Akhil Pandey, NDP's principal executive  
officer. The good news for Linux? As all  
those girls from Cotton Hill—and mil-  
lions of other students—grow up using  
the software, those issues may no longer  
loom so large. ■

—With Steve Hamm in New York and  
Jay Greene in Seattle





## CHINA

# HOW BEIJING IS KEEPING BANKS AT BAY

It's building barriers to full access by foreign financial companies despite its WTO pledge

BY BRIAN BREMNER AND  
DEXTER ROBERTS

**D**EC. 11, 2006, IS MEANT to be a red-letter day for Chinese banking. That's when the mainland's finance sector is to be fully opened to foreign banks under commitments Beijing made when it joined the World Trade Organization. For years overseas financial houses have been preparing for the day, when they'll be allowed to offer a wide range of banking services to individual Chinese savers. All told, foreigners have spent more than \$23 billion on stakes in 20 Chinese banks, dreaming of introducing mainlanders to credit cards, mortgages, and personal finance.

The reality may turn out to be far different. Western financial outfits are effectively fenced off from retail banking and insurance by rigid investment caps and regulations that make going solo frightfully expensive. And on Sept. 14, Beijing added rules barring new foreign investment in brokerages. Some say it's all part

of a subtle strategy to open things up just enough to ward off a WTO legal challenge but introduce regulations that tilt things in favor of the home team. "China is in compliance with its basic WTO commitments, but it has created regulatory and procedural barriers that hinder full access," says James M. Zimmerman, an attorney with Squire, Sanders & Dempsey in Beijing.

In theory, foreign banks will be able to open branches from Hainan to Harbin. Yet few will do so because foreigners can open only one branch a year, and each branch must have operating capital of \$50 million, a burden local banks don't face. Committing \$500 million to open 10 branches in a decade doesn't make a lot of sense, so foreigners instead have bought equity stakes in local banks. The problem is that Beijing limits total foreign ownership in any Chinese bank to

**UPHILL FIGHT** The betting is against Citi's bid to buy half of a Guangdong bank

25%, and any individual bank can hold just 20%. A minority share

holders, foreigners don't have much say in strategy. Last year, for instance, Bank of America Corp. spent \$3 billion for 9% of China Construction Bank Corp. But the Americans have only one seat on the board and had to abandon their own mainland retail effort as part of the deal.

## PROTECTIONIST TONE

WHILE WTO RULES don't require China to offer foreigners majority control of local banks, that's the practice in Japan and Korea. Still, the Chinese show no signs of budging on the 25% investment cap. Citigroup, which has ties to China dating to 1902, assembled a team of investors to buy a larger anti-reform trend. Beijing recently tightened regulations on foreign real estate transactions and has added limits on acquisitions by overseas investors, a strategy at odds with its past liberal policy on foreign investment. Also on Sept. 10, the government introduced rules barring financial information companies such as Reuters Group PLC and Bloomberg Financial Markets from selling their data directly to Chinese banks and brokerages. Instead, their news feeds will be vetted and distributed by a mainland rival, Xinhua. "A lot of the new regulations coming out seem to have a heavy economic protectionist component to them," says Michael Dardzinski, an attorney with San Francisco-based Orrick, Herrington & Sutcliffe in Beijing.

Beijing denies any effort to block access to the market. True, foreigners control just 2% of assets in the banking system. Nonetheless, China "mainly committed opening the financial sector in 2007,"

## THE STAT

**\$23**  
Billion

Amount foreigners have paid for stakes in Chinese banks

finance Vice-Minister Li Yong said at a World Bank meeting in Singapore Sept. 16. Adds Wang Yong, director of the Beijing University Center for International Political Economy: "The problem the U.S. banking sector is not patient."

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## ENERGY

# A GUSHER FOR BIG OIL IS DRYING UP

Western giants used to have easy pickings in Russia. Now Moscow is taking a harder line

BY STANLEY REED AND JASON BUSH

IT'S A NEW WORLD FOR OIL COMPANIES, as Royal Dutch Shell PLC, Exxon Mobil Corp., and others are learning the hard way in Russia. In the mid-1990s, the country was in economic turmoil. So the Kremlin agreed to advantageous deals for Western oil majors, which agreed to use their capital and technology to expand oil

55% owned by Shell. The ministry's decision could halt construction work on the development, which is 75% complete. "Russia and other oil producers now consider everything negotiable," says Julia Nanay, a Russia specialist at PFC Energy in Washington.

The oil majors in Russia find themselves in a tricky situation. They took big risks in return for what they thought were ironclad, highly lucrative deals, and they

year. Moreover, national companies, led by gas giant Gazprom, want to dominate anything new and exciting in energy, especially liquefied natural gas (LNG). Sakhalin II is Russia's first LNG project and is expected to supply 7.5% of the world market. "Gazprom wants to get a chance to understand LNG, and they also want to maintain its monopoly on exports," says Ronald Smith, head of research at Alfa-Bank in Moscow.

## TIGHT SPOT

THE CONCERNS RAISED by environmentalists, including fears that pipelines could threaten salmon-filled rivers, are legitimate. But industry insiders say that Russians may be hitting Shell on the environment to force the company to make concessions elsewhere. One big issue has been the doubling in costs, to \$20 billion, that Shell announced last year. Under Shell's 1994 agreement, the Russian government would foot most of the bill, since the deal allows Sakhalin Energy to recover its development costs before sharing revenues with Moscow. Even then, Russian share increases slowly, from 10% to 70% only as certain profit targets are met. The



**SAKHALIN II**  
Cost overruns by Shell have angered Moscow

## Sakhalin in Brief

### SAKHALIN I

LEAD COMPANY: ExxonMobil  
PARTNER: Rosneft  
COST: \$17 billion  
RESERVES: 5.4 billion barrels\*

### SAKHALIN II

LEAD COMPANY: Royal Dutch Shell  
PARTNERS: Mitsubishi, Mitsui  
COST: \$20 billion  
RESERVES: 4.7 billion barrels\*

\*of oil equivalent

Data: Companies, BusinessWeek

and gas production into new areas, particularly the icy waters off Sakhalin Island in Asia.

Today, full of self-confidence—and cash—from sky-high oil revenues, Russia has a much stronger hand. So President V. Vladimir Putin's government is looking much less favorably on the agreements made with Big Oil. "The Russians feel they have provided the international companies with privileged positions," says an oil company source. That became clear on Sept. 18, when Russia's Natural Resources Ministry yanked its environmental approval of Sakhalin II. The \$20 billion oil and gas project is being developed by Sakhalin Energy, a venture that's

don't want to give ground. But they may not have a choice if they hope to be players in what has become the world's top oil producing country. "Long term, the market is going to drive global energy companies to find a different business model for investing in Russia," says Andrew Somers, president of the American Chamber of Commerce in Moscow.

A game of chicken is evolving. The Western companies are toughing it out while Russian authorities gauge how much they can afford to irritate investors. For now, the Russians are negotiating from a position of strength. They're awash in money, with oil and gas revenues expected to hit \$170 billion this

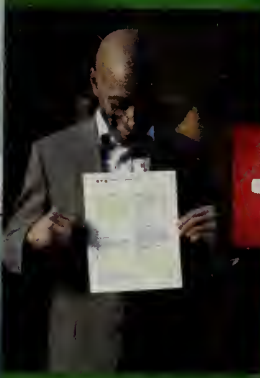
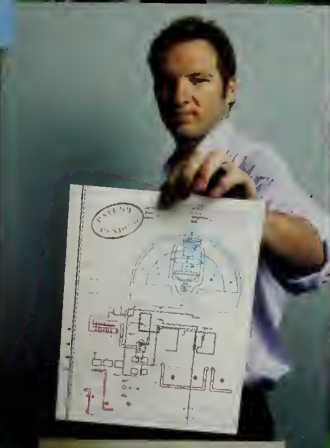
disagreement over costs is complicating Shell's talks with Gazprom on a swap that would give the Russian company 25% of Sakhalin II return for 50% of Siberian gas field. Analysts say Shell may have to swallow some of the overruns to give Gazprom a sweeter deal.

Shell isn't the only company that could run into trouble at Sakhalin. ExxonMobil wants to extend the boundaries of its concession, called Sakhalin I, because the field extends beyond current limits. But the Russians are balking. The company says that under its agreement extension should be automatic and that if Russia doesn't honor the pact, foreign investor confidence in the country could fall.

ExxonMobil may be in a better position than Shell because it hasn't had a "major screwup" such as the huge cost overruns, says one analyst. Still, as long as oil prices remain high and nationalism strong, the Western oil companies are likely to face a tougher time in Russia. ■

—With Mark Morrison in Austin, Texas

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invent



# click fraud

The dark side of online advertising

By Brian Grow and Ben Elgin

**m**artin Fleischmann put his faith in on-line advertising. He used it to build his Atlanta company, MostChoice.com, which offers consumers rate quotes and other information on insurance and mortgages. Last year he paid Yahoo! Inc. and Google Inc. a total of \$2 million in advertising fees. The 40-year-old entrepreneur believed the celebrated promise of Internet marketing: You pay only when prospective customers click on your ads.

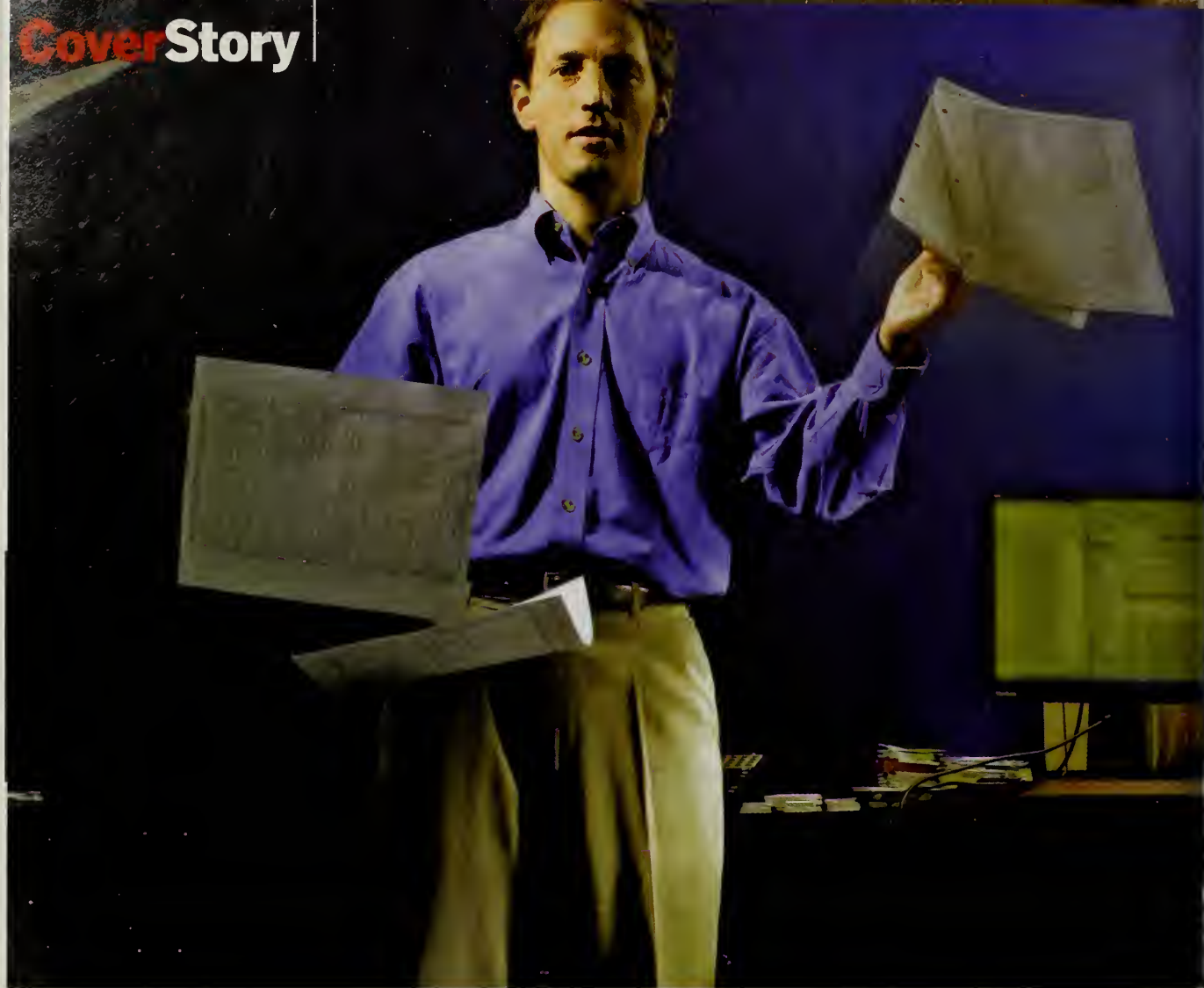
Now, Fleischmann's faith has been shaken. Over the past three years, he has noticed a growing number of puzzling clicks coming from such places as Botswana, Mongolia, and Syria. This seemed strange, since MostChoice steers customers to insurance and mortgage brokers only in the U.S. Fleischmann, who has an economics degree from Yale University and an MBA from Wharton, has used specially designed software to discover that the MostChoice ads being clicked from distant shores had appeared not on pages of Google or Yahoo but on curious Web sites with names like insurance1472.com and insurance060.com. He smelled a swindle, and he calculates it has cost his business more than \$100,000 since 2003.

Fleischmann is a victim of click fraud: a dizzying collection of scams and deceptions that inflate advertising bills for thousands of companies of all sizes. The spreading scourge poses the single biggest threat to the Internet's advertising gold mine and is the most nettlesome question facing Google and

HARRY CAMPBELL







Yahoo, whose digital empires depend on all that gold.

The growing ranks of businesspeople worried about click fraud typically have no complaint about versions of their ads that appear on actual Google or Yahoo Web pages, often next to search results. The trouble arises when the Internet giants boost their profits by recycling ads to millions of other sites, ranging from the familiar, such as *cnn.com*, to dummy Web addresses like *insurance1472.com*, which display lists of ads and little if anything else. When somebody clicks on these recycled ads, marketers such as MostChoice get billed, sometimes even if the clicks appear to come from Mongolia. Google or Yahoo then share the revenue with a daisy chain of Web site hosts and operators. A penny or so even trickles down to the lowly clickers. That means Google and Yahoo at

times passively profit from click fraud and, in theory, have an incentive to tolerate it. So do smaller search engines and marketing networks that similarly recycle ads.

## Slipping Confidence

GOOGLE AND YAHOO SAY they filter out most questionable clicks and either don't charge for them or reimburse advertisers that have been wrongly billed. Determined to prevent backlash, the Internet ad titans say the extent of click chicanery has been exaggerated, and they stress that they combat the problem vigorously. "We think click fraud is a serious but manageable issue," says John Slade, Yahoo's senior director

## rogues glossary

The murky world of Web advertising has its own jargon

### click fraud

Clicking on Internet advertising solely to generate illegitimate revenue for the Web site carrying the ads; those doing the clicking typically also get paid.

### parked web site

A site typically with little content except for lists of Internet ads, often supplied by Google or Yahoo; many are the source of false

global product management. "Google strives to detect every invalid click that passes through its system," says Shuman Ghosemajumder, the search engine's manager for trust and safety. "It's absolutely in our best interest for advertisers to have confidence in this industry."

That confidence may be slipping. A *BusinessWeek* investigation has revealed a thriving click-fraud underground populated by swarms of small-time players, making detection difficult. "Paid to read" rings with hundreds or thousands of members each, all of them pressing PC mice over and over in living rooms and dens around the world. In some cases, "clickbot" software generates page hits automatically and anonymously. Participants from Kentucky to China speak of making from \$25 to several thousand dollars a month apiece, cash they wouldn't receive if Google and Yahoo were as successful at blocking fraud as they claim.

"It's not that much different from someone coming up and taking money out of your wallet," says David Struck. He and his wife, Renee, both 35, say they dabbled in click fraud last year, making more than \$5,000 in four months. Employing a common scheme, the McGregor (Minn.) couple set up

my Web sites filled with nothing but recycled Google and Yahoo advertisements. Then they paid others small amounts to visit the sites, where it was understood they would click on the ads, says David Struck. It was "way too easy," he says. Gradually, he says, he and his wife began to realize they were cheating unwitting advertisers, so they stopped. "What Google and Yahoo are doing [to stop fraud], it's not having much of an effect," he says.

Spending on Internet ads is growing faster than any other part of the advertising industry and is expected to surge from \$5 billion last year to \$29 billion in 2010 in the U.S. alone, according to researcher eMarketer Inc. About half of these dollars are going into deals requiring advertisers to pay by the click. Most other Internet ads are priced according to "im-

pressions," or how many people view them. Yahoo executives warned on Sept. 19 that weak ad spending by auto and financial-services companies would hurt its third-quarter revenue. Share prices of Yahoo and Google tumbled on the news.

Google and Yahoo are grabbing billions of dollars once collected by traditional print and broadcast outlets, based partly on the assumption that clicks are a reliable, quantifiable measure of consumer interest that the older media simply can't match. But the huge influx of cash for online ads has attracted armies of con artists whose activities are eroding that crucial assumption and could eat into the optimistic expectations for online advertising. (Advertisers generally don't grumble about fraudulent clicks coming from the Web sites of traditional media outlets. But there are growing concerns about these media sites exaggerating how many visitors they have—the online version of inflating circulation.)

## The success of Google and Yahoo is based partly on the idea that clicks are reliable

Most academics and consultants who study online advertising estimate that 10% to 15% of ad clicks are fake, representing roughly \$1 billion in annual billings. Usually the search engines divide these proceeds with several players: First, there are intermediaries known as "domain parking" companies, to which the search engines redistribute their ads. Domain parkers host "parked" Web sites, many of which are those dummy sites containing only ads. Cheats who own parked sites obtain search-engine ads from the domain parkers and arrange for the ads to be clicked on, triggering bills to advertisers. In all, \$300 million to \$500 million a year could be flowing to the click-fraud industry.

Law enforcement has only lately started focusing on the threat. A cybercrime unit led by the FBI and U.S. Postal Inspection Service just last month assigned two analysts to examine whether federal laws are being violated. The FBI acted after noticing suspected cybercriminals discussing click fraud in chat rooms. The staff of the Senate Judiciary Committee has launched its own informal probe.

Many advertisers, meanwhile, are starting to get antsy. Google and Yahoo have each settled a class action filed by marketers (page 52). In late September a coalition of such major brands as InterActive Corp.'s Expedia.com travel site and mortgage broker LendingTree is planning to go public with its mounting unease over click fraud, *BusinessWeek* has learned. The companies intend to form a group to share information and pressure Google and Yahoo to be more forthcoming. "You

### -to-read

Site pays members to visit other Web sites and from marketers; often produce fake clicks on Web sites.

### clickbot

Software that can be used to produce automatic clicks on ads; some versions employed in click fraud can mask the origin and timing of clicks.

### botnet

A collection of computers infected with software that allows them to be operated remotely; networks of thousands of machines can be used in click fraud.

SCHMANN  
nates fraud has  
his Atlanta  
pany \$100,000



can't blame the advertisers for being suspicious," says Robert Pettee, search marketing manager for LendingTree, based in Charlotte, N.C. "If it's your money that's going out the door, you need to be asking questions." He says that up to 15% of the clicks on his company's ads are bogus.

In June, researcher Outsell Inc. released a blind survey of 407 advertisers, 37% of which said they had reduced or were planning to reduce their pay-per-click budgets because of fraud concerns. "The click fraud and bad sites are driving people away," says Fleischmann. He's trimming his online ad budget by 15% this year.

Google and Yahoo insist there's no reason to fret. They say they use sophisticated algorithms and intelligence from advertisers to identify the vast majority of fake clicks. But the big search engines won't disclose the specifics of their methods, saying illicit clickers would exploit the information.

Some people who have worked in the industry say that as long as Google and Yahoo distribute ads to nearly anyone with a rudimentary Web site, fraud will continue. "Advertisers should be concerned," says a former Yahoo manager who requested anonymity. "A well-executed click-fraud attack is nearly impossible, if not impossible, to detect."

ALTHOUGH 5 FEET 6 AND 135 POUNDS, Marty Fleischmann is no one to push around. He barked orders at much bigger oarsmen while serving as coxswain on the varsity crew team



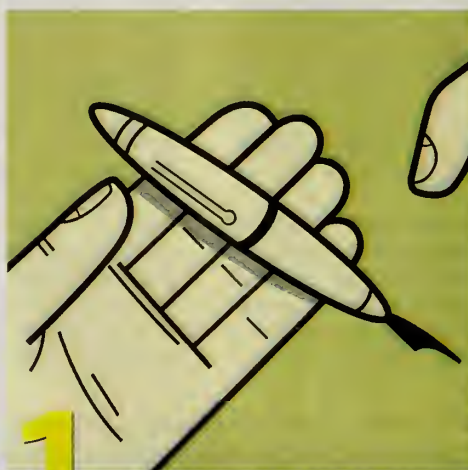
**DAVID AND RENEE STRUCK** set up dummy Web sites with recycled ads

at Yale in the mid-1980s. His shyness deficit surfaced again when he later played the role of Jerry Seinfeld in the student follies at Wharton. Married and the father of three children, he tends to pepper his conversation with jargon about incentives and efficiencies.

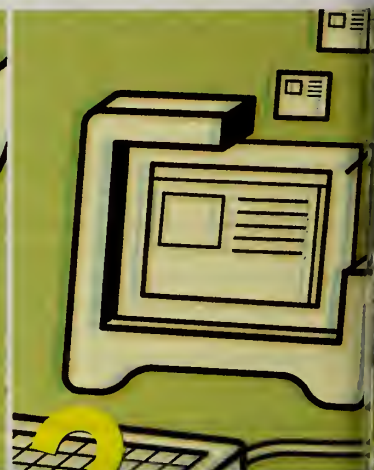
Before he and partner Michael Levy co-founded their financial-information company in 1999, Fleischmann worked in Atlanta at the management consulting firm A.T. Kearney Inc., advising major corporations in the shipping and pharmaceutical

## follow the money

Click fraud schemes vary and often involve a complicated chain of relationships. Here's one way the process can work:



**1** XYZ Widgets signs up with Google or Yahoo to advertise on the Internet, agreeing to pay the search engine every time somebody clicks on an XYZ ad.



**2** Google or Yahoo displays the ad on its own site but also recycles it to millions of affiliates, including "domain parking" companies.



ustries. One lesson he says he learned is that big companies loath to cut off any steady source of revenue. Google and Yahoo are no different, he argues.

That cynicism several years ago contributed to MostChoice's assigning an in-house programmer to design a system for analyzing every click on a company ad: the Web page where the ad appeared, the clicker's country, the length of the clicker's visit to MostChoice's site, and whether the visitor became a customer. Few companies go to such lengths, let alone companies with only 30 employees and revenue last year of just \$6.4 million.

To Fleischmann, the validity of his clicks, for which he pays \$8 apiece, has become an obsession. Every day he pores over fresh spreadsheets of click analysis. "I told Yahoo years ago," he says, "If this was costing you money instead of making you money, you would have stopped this."

Google, he says, does a better job than Yahoo of screening for fraud. But neither adequately protects marketers, he argues. Until March, 2005, Google, based in Mountain View, Calif., charged advertisers twice for "double clicks," meaning those occasions when a user unnecessarily clicks twice in quick succession on an ad. Confirming this, Google's Ghosejumper says that before the company made the change, it had to focus "on issues of malicious behavior," though now it identifies double clicks and bills for only one.

## Korean Clones

FLEISCHMANN'S DAILY IMMERSION in click statistics fuels his indignation. How, he wants to know, did he receive traffic this summer from PCs in South Korea which are clicking on insurance1472.com and insurance060.com? The only content on these identical sites—and five other clones with similar names—lists of Yahoo ads, which occasionally have included

**"If this was costing [Yahoo] money instead of making it, they would have stopped it"**

MostChoice promotions. Fleischmann's spreadsheets revealed, not surprisingly, that all of the suspected Korean clickers left his site in a matter of seconds, and none became customers. The two individuals registered as owning the mysterious insurance sites are based in South Korea. They didn't respond to requests for comment, and most of the sites disappeared in late summer, after MostChoice challenged Yahoo about them.

Fleischmann, like most other advertisers, has agreed to let Google and Yahoo recycle his ads on affiliated sites. The search engines describe these affiliates in glowing terms. A Google "help" page entitled "Where will my ads appear?" mentions such brand names as AOL.com and the Web site of *The New York Times*. Left unmentioned are the parked Web sites filled exclusively with ads and sometimes associated with click-fraud rings.

Google and Yahoo defend their practice of recycling advertising to domain-parking firms and then on to parked sites, saying that the lists of ads on the sites help point Internet surfers toward relevant information. Google notes that it allows advertisers to identify sites on which they don't want their ads to run.

But this Google feature doesn't apply to many parked sites, and Yahoo doesn't offer the option at all. In any event, excluding individual sites is difficult for marketers that don't do the sort of time-consuming research MostChoice does. Whether they know it or not, many other companies are afflicted in similar ways. At *BusinessWeek's* request, Click Forensics Inc., an online auditing firm in San Antonio, analyzed the records of its 170 financial-services clients and found that from March



**3** Domain-parking outfits feed the Google ad to thousands of "paid to read" Web sites, some of which are nothing more than click farms.



**4** A fraud artist who owns a parked site circulates it to "paid to read" (PTR) groups, whose members receive small payments to visit sites and click on ads.



**5** When a PTR member clicks on the XYZ ad, the company is billed. Yahoo or Google shares the proceeds with the domain parker, the fraudster, and the clickers.



through July of this year, 13 companies had received clicks from Web sites identified as dubious by MostChoice.

Yahoo declined to comment on insurance1472, -060, and other suspect sites in its ad network. The Sunnyvale (Calif.) search giant stressed that in many cases it doesn't deal directly with parked sites; instead, it distributes its ads by means of domain-parking firms.

*BusinessWeek's* independent analysis of the MostChoice records turned up additional indications of click fraud. Over the past six months, the company received 139 visitors through an advertisement on the parked site healthinsurancebids.com, which offers only ads supplied by Yahoo. Most of these visitors were located in Bulgaria, the Czech Republic, Egypt, and Ukraine. Their average stay on MostChoice.com was only six seconds, and none of them became a customer.

Healthinsurancebids.com offers a revealing entry point into the click-fraud realm. It is one of several parked sites registered to Roland Kiss of Budapest. Kiss also owns BestPTRsite.com. "PTR" refers to "paid to read." In theory, paid-to-read sites recruit members who agree to read marketing e-mails and Web sites tailored to their interests. PTR site operators pay members for each e-mail and Web site they read, usually a penny or less.

In reality, many PTR sites are click-fraud rings, some with hundreds or thousands of participants paid to click on ads.



**SMELKOV** says his clickbot in Siberia generates \$10,000 a year for him

BestPTRsite says it has 977 members. On Aug. 23 its administrators sent an e-mail to members containing a list of parked sites filled with ads. One of these sites, mortgagebg.com, which is also registered to Kiss, has been a source of apparently bogus clicks on MostChoice. The e-mail instructed members to click on different links every day, a common means to avoid detection. Members were also told to cut and paste text from the Web pages they click as proof of their activity. "If you send us back always the same link you will get banned and not paid! So take care and visit everyday a new link," the e-mail said.

Reached by telephone, Kiss says that his registration name is false and declines to reveal the real one. He says he's the 21-year-old son of computer technicians and has studied finance. He owns about 20 paid-to-read sites, he says, as well as 20 parked sites stuffed with Google and Yahoo advertisements. But he says he will take down healthinsurancebids.com to avoid discovery. He claims to take in \$70,000 in ad revenue a month, but says that only 10% of that comes from PTRs. The rest, he says, reflects legitimate clicks by real Web surfers. If he refrains from more PTR activity, he claims, because "it's good for advertisers, no good for Google, no good for Yahoo." It's not unusual for people who are involved in PTR activity

## taking the search engines to court

**U**nder pressure from advertisers, Google Inc. and Yahoo! Inc. are adjusting the way they deal with click fraud. Several lawsuits filed on behalf of hundreds of advertisers have helped fuel the modest changes.

In June, Yahoo agreed to settle a class action filed in federal court in Los Angeles on behalf of advertisers alleging they had been billed for fake clicks. Without admitting wrongdoing, Yahoo said it would grant

refunds for bad clicks since January, 2004, that advertisers bring to its attention. The potential cost to Yahoo isn't clear. The company also agreed to appoint an in-house advocate to represent advertisers. The search engine said it would periodically invite marketers to inspect its now-secret fraud-detection systems. Separate from the settlement, Yahoo says that next year it will give marketers more control over where their ads appear.

Google reached its own settlement with unhappy advertisers in July in state court in Texarkana, Ark., where a judge approved a pact valued at \$90 million. The agreement provides \$30 million in cash for lawyers but only advertising credits for class members. Dissatisfied, a group of advertisers is seeking to challenge the settlement in appellate court. "The rot is so pervasive," says Clarence E. Briggs III, a leader of the breakaway group. Briggs, a former Army ranger, says his company, Advanced Internet Technologies in Fayetteville, N.C., has detected \$90,000 of bad clicks on its Google ads.

Google, which denied any liability, has since announced it will pull back its cloak of secrecy and show individual advertisers the proportion of their clicks it has deemed invalid and for which they weren't billed.

—Ben Elgin and Brian Grow

### evolution of a scam

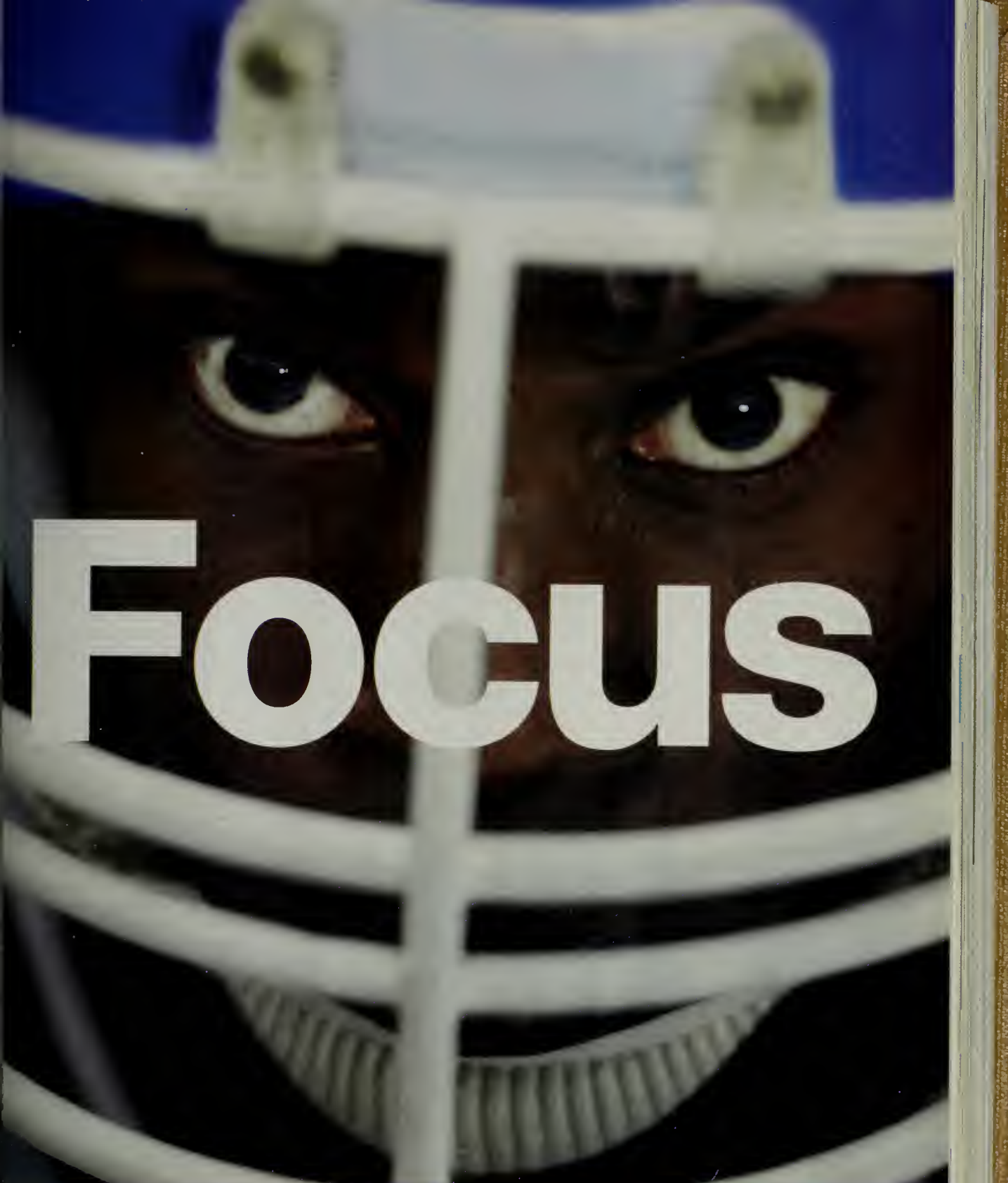
The purpose of click fraud has changed in recent years

#### version 1.0

Companies clicked on a rival's Internet advertisements, running up its ad bills and squeezing the competition. The ads in question typically appeared on Google, Yahoo, and other search engine sites.

#### version 2.0

Today click fraud is much more likely to occur on small Web sites that carry ads recycled from Yahoo and Google. Fraudsters arrange for fake clicks on the ads and split the resulting revenue with the search engines.



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profess that they restrict their behavior in some way for the good of advertisers and the big search engines.

After joining several PTR groups, *BusinessWeek* reporters received a torrent of e-mail showcasing hundreds of parked sites filled with Google and Yahoo ads. The groups urged participants to click aggressively on ads. "People don't click because they're interested in the subject," says Pam Parrish, a medical editor in Indianapolis who has participated in PTR sites. "They're clicking on ads to get paid."

Parrish, 52, says that when she started three years ago, PTR sites drew clickers like herself: potential customers looking to pick up a few spare dollars. At one point, she says she belonged to as many as 50 such sites but earned only about \$200 all told.

More recently, she says, most PTR sites have dropped the pretense of caring whether members are interested in the site they visit. Parrish and others active on PTR sites say click fraud became more blatant as Google and Yahoo made their ads more widely available to parked sites.

Google and Yahoo say they filter out most PTR activity. "We manage that very well," says Google's Ghosemajumder. "It hasn't been an issue across our network, but it's something we take very seriously." Yahoo adds that PTR sites carrying its ads are in "very serious violation" of its standard distribution agreement. Yahoo says it scans its network for PTR activity, but declines to describe its methods.

PTR impresarios often don't fit the profile of an illicit kingpin.

## advertisers in china are getting burned, too

**C**hina has a reputation in the U.S. as a haven for click-fraud artists. Now, Chinese advertisers say they, too, have fallen victim to the proliferating racket.

In August, Chinese advertisers carrying placards even staged a small demonstration in front of the Beijing office of Baidu.com, China's top search engine. Leading the protest was Dr. Liu Wenhua, director of the Beijing Zhongbei Cancer Medical Research Center. Liu claims that his center, which advertises its services online, has suffered from fraudulent clicks on its ads on a Baidu-affiliated music and entertainment site. Baidu has offered a refund, Liu says, but he turned it down, preferring to take Baidu to court. "I'm not satisfied," the doctor says.

Zhang Xinwei, a partner with the Beijing Hetong Law Office, represents Liu and four other advertisers that also have sued Baidu, alleging fraud. "The problem is very

serious," says Zhang. Another plaintiff, Land of Maples Tourism & Culture Exchange, a Beijing travel agency specializing in trips to Canada, has hired a different lawyer. Steven Donne, who runs the agency, says he became suspicious of a batch of 600 clicks this summer because they all came from one source. But Donne feared he wouldn't be able to prove click fraud, so his suit focuses on a claim that Baidu manipulates search results to punish certain advertisers. The legal cases are all in a preliminary stage.

Baidu officials declined to comment but provided a statement denying any impropriety. "Baidu places the highest priority on preventing fraudulent clicks," it said. "We have set up numerous measures both through automated technology and manual efforts to prevent fraudulent clicks

and the effectiveness of which [has] been verified by [an] independent third party.... We are, however, continuing to invest aggressively in safeguarding measures which will help ensure that our customers and users continue to have the best possible experience."

Despite such assurances, advertisers say concern is spreading. Executives at Analysys International, an info tech researcher in Beijing, noted earlier this year that clicks on its ads on Baidu soared without any uptick in business. In April alone, Analysys burned through one-third of its modest yearly online marketing budget of \$3,800. "It was like crazy," says CEO Edward Yu.

This spring, Analysys conducted a survey of 2,000 online advertisers in China and found that one-third believe they have been click-fraud victims. Yu continues to patronize Google's Chinese affiliate,

but he has stopped buying advertising from Baidu and Yahoo China, which is owned by Alibaba.com. Porter Erisman, a spokesman for Alibaba, said in an e-mail that "click fraud is a serious but manageable issue," adding that less than 0.01% of his company's customers have complained.

—Bruce Einhorn



bona fide

bonehead

in. Michele Ballard runs a 2,200-member network called the-Owl-Post.com from her home in the small town of Hartford, Ky. On disability since a 1996 car accident, Ballard, 36, lives with her ailing mother and her cat, Sassy. She says she works day and night running Owl-Post, a five-year-old group named after the postal system in the Harry Potter novels. Sometimes, Ballard says she takes a break at nighttime to tend her vegetable garden or help her elderly neighbors with theirs.

She sends her members a daily e-mail containing links to parked Web pages, many of them filled with Google ads. Her e-mails, decorated with smiley faces, suggest to members: "If you could just give a click on something on each page." She owns some of the parked pages, so she gets a share of the revenue when ads on them are clicked. She claims her take amounts to only about \$60 a month, noting that if she made more than \$85, the government would reduce her \$601 monthly disability check.

In August, Google cut off a domain parking firm that hosts some of Ballard's sites. Showing her resilience, she moved the sites to other domain parkers, although none of those currently distributes Google ads. "Google would prefer you not to find out ads on paid e-mails, because they get too much crap-traffic," she says in a phone interview. She realizes that advertisers would get angry "if they knew we were just sitting there, clicking and not interested" in their wares. But, she adds, "They haven't figured that out yet."

Despite these views, Ballard says she doesn't think she's doing anything improper, let alone illegal. While investigations of some Internet criminals have revealed evidence of click fraud, the activity itself hasn't been the subject of prosecution. Ballard says Owl-Post is "like a huge family" whose members sometimes help out colleagues in financial distress. She says the network includes people who have low incomes and are desperate to earn cash to pay their bills. "A lot of people would



#### GHOSEMAJUMDER

The Google official says filters usually catch click fraud

be hurt if [the PTR business] crashed," she says.

Google's Ghosemajumder says any operation inviting people to click on ads is encouraging fraud, but he expresses skepticism about the overall scale of PTR activity: "People have a great tendency to exaggerate when they say they can attack Google's service."

Networks of human clickers aren't the only source of fake Web traffic. Scores of automated clicking programs, known as clickbots, are available to be downloaded from the Internet and claim to provide protection against detection. "The primary use is to cheat advertising companies," says Anatoly Smelkov, creator of Clicking Agent, a clickbot he says he has sold to some 5,000 customers worldwide.

The brazen 32-year-old Russian software developer lives in the city of Novosibirsk in western Siberia and says he received a physics degree from the state university there. A fan of the British physicist and author Stephen W. Hawking, Smelkov says Clicking Agent is a sideline that generates about \$10,000 a year for him; he also

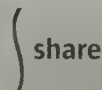
**"A lot of people would be hurt [if the paid-to-read business] crashed," says one organizer**

writes software for video sharing and other purposes.

Clickbots are popular among online cheats because they disguise a PC's unique numerical identification, or IP address, and can space clicks minutes apart to make them less conspicuous. Smelkov shrugs off his role in facilitating deception. He points out that the first four letters of the name of his com-

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pany, LoteSoft Co., stand for "living on the edge." Teasing, he asks: "You aren't going to send the FBI to me, are you?"

Google and Yahoo say they can identify automated click fraud and discount advertisers' bills accordingly. Jianhui Shi, a Smelkov customer who goes by the name Johnny, says that for this very reason he steers away from Google and Yahoo ads. An unemployed resident of the booming southern Chinese city of Shenzhen, Jianhui says he has used Clicking Agent to click all sorts of ads on sites he controls, making about \$20,000 a year from this activity. While he doesn't click on Google and Yahoo ads, he says that more skilled Chinese programmers modify Clicking Agent to outwit the American search engines. "Many in China use this tool to make money," he wrote in an e-mail to *BusinessWeek*.

Back at the bare-bones MostChoice offices in north Atlanta, Marty Fleischmann continues to demand recompense. He says he has received refunds from Google and Yahoo totaling only about \$35,000 out of the \$100,000 he feels he is owed. In one exchange, MostChoice e-mailed Google to point out 316 clicks it received in June from ZapMeta.com, a little-known search site. MostChoice paid an average of \$4.56 a click, or roughly \$1,500 for the batch. Only one converted into a customer. Google initially responded that "after a thorough manual review" some bad clicks were filtered out before MostChoice was charged. Refund request: denied.

But as clicks from ZapMeta kept arriving, Fleischmann demanded in an Aug. 7 e-mail to Google: "You should be trusting us and doing something about [ZapMeta] as a partner, in-

stead of finding more ways to refute our data or requests." (*BusinessWeek's* e-mail to ZapMeta's site and its registered owner, Kevin H. Nguyen, elicited no response.)

Finally, on Aug. 8, Google admitted that clicks from ZapMeta "seem to be coming through sophisticated means." A Google employee who identified himself only as "Jason" added in an e-mail: "We are working with our engineers to prevent these clicks from continuing." MostChoice received a \$2,527.93 refund that included reimbursement for suspect clicks from an additional site as well.

Google says it has refunded MostChoice for all invalid clicks and won't charge for any additional ZapMeta clicks until the situation is resolved. But Google also says it doesn't believe ZapMeta has done anything improper. As of late September, ZapMeta continued to carry ads that had been recy-

cled from Google, although not MostChoice ads.

Randall S. Hansen, a professor of marketing at Stetson University in Deland, Fla., sees a larger lesson in tales of this sort. "We are just beginning to see more and more mainstream advertisers make the Internet a bigger part of their ad budget and move dollars from print and TV," says Hansen, who has held marketing jobs at *The New Yorker* and *People* magazines. "But if we can't fix this click-fraud problem, then it is going to scare away the further development of the Internet as an advertising medium. If there is an undercurrent of fraud, then why should a large advertiser be losing \$1 million, or maybe not know how much it is losing?" ■

—With Moira Herbol

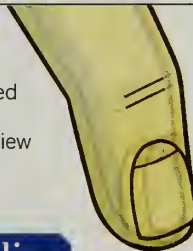
## Mass-Producing Click Fraud

**BotNets** How huge networks of zombie computers, operated remotely, are being used to commit click fraud from afar.

**The story behind the story:** A podcast interview with reporters Brian Grow and Ben Elgin by Executive Editor John A. Byrne.

**BusinessWeek** online

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## past media scandals

Allegations that some publishers and TV companies deceive advertisers go back many decades. Now the problem has moved online:

### newspapers and magazines

Outrage over circulation fraud, employed to boost ad rates, led to the 1914 creation of the Audit Bureau of Circulations. But that didn't stop some publishers from faking the numbers. In 2004 a scandal tainted Tribune's *Newsday* and its Spanish-language *Hoy*, Belo's *Dallas Morning News*, and Sun-Times Media's *Chicago Sun-Times*.

### television

Broadcasters set ad rates using surveys of how many people are tuned in during four "sweeps" periods a year. Advertisers complain that some networks and local stations use contests and other stunts to attract extra attention during sweeps. The American Association of Advertising Agencies says this practice "has been going on for decades."

### internet

Click fraud, generating bogus mouse clicks on an online ad, isn't the only way advertisers can get ripped off on the Internet. Some ads are priced according to "impressions," the number of Web surfers who see it, regardless of whether they click. Now there is concern that some media companies commit impression fraud by overstating the number of visitors to their sites.



# doing business with a controversial partner

**T**he relationship between Yahoo! and an obscure Web site called Oemji.com illustrates why a growing number of companies are worried about where their online ads are turning up and who's actually clicking on them.

Yahoo recycles ads to Oemji even though several leading Internet security firms claim the site's owner also distributes software that can deceive and annoy computer users. Yahoo's own correspondence with Oemji's parent, Oemtec Ltd., confirms that the online giant knows about the controversy. Yet Yahoo continues to send ads to Oemji that advertisers and online experts allege result in dubious clicks and inflated bills.

Yahoo formalized its link to Oemtec in an Apr. 14, 2004, contract providing that Oemtec, which is registered in Barbados, would become one of the thousands of site owners that receive Yahoo ads. The contract, reviewed by *BusinessWeek*, states that Oemtec would receive 55% of the revenue from clicks on ads that Yahoo distributes to Oemji. Since advertisers pay Yahoo from a few cents to more than \$20 a click, Oemtec's share of revenue from Yahoo could total many thousands of dollars a year.

Oemji isn't a "parked" site offering only lists of ads. It features its own search engine, news and weather reports, and a program called Oemji Bar, which can be downloaded as a PC's search engine. Still, advertisers are questioning the quality of clicks from ads on Oemji, says Click Forensics Inc., an online auditing firm in San Antonio. Last month, Click Forensics found that nine of its advertiser customers received suspicious clicks via Oemji that originated in Asia, Africa, and other distant regions. "You don't see that kind of traffic unless there is something sneaky going on," says Tom Charvet, vice-president of technology at Click Forensics.

One frustrated advertiser is MostChoice.com. Chief Executive Martin Fleischmann says that, in the past year, Yahoo charged the online-financial-information provider an estimated \$10,300 for 2,690 clicks from visitors to Oemji.

Ninety percent of the clicks came from such places as Mongolia, Vietnam, and Honduras, where MostChoice does no business. Only eight clicks, less than 0.3%, turned into sales, compared with 30% or more from clicks on ads on Yahoo's own Web site.

Questions about Oemji have arisen elsewhere. Computer security firms Sunbelt Software Inc. and Aladdin Knowledge Systems Inc. have posted consumer warnings, calling Oemji Bar a "browser hijacker," meaning software that can replace unwary PC users' search engines without permission, sometimes as they download

# YAHOO!

other software from Oemtec.

Four other security firms, including giant Symantec Corp., have issued alerts about a different Oemtec product called SpySpotter. Available until last month at spyspotter.com, this program is supposed to clean computers of spyware—programs that can track users' Web surfing and send them pop-up ads. But Symantec and the others say SpySpotter is actually a "security risk"

## Yahoo turns ads over to a company associated with suspicious clicks, inflated bills, and "rogue" software

or "rogue" product, because it can install itself without permission and send exaggerated spyware warnings to entice PC users to sign up for a \$29.95 annual subscription. "SpySpotter for a very long time has had a bad history of being force-installed or stealth-installed on people's PCs," says Eric L. Howes, who heads research on pernicious programs at Clearwater (Fla.)-based Sunbelt Software.

Some security companies, such as PC Tools and CA Inc., have removed "browser hijacker" ratings of Oemji Bar as new versions have been released. But "older

versions still in distribution are browser hijackers," says Sam Curry, vice-president of security management at CA.

Yahoo knows about Oemtec's reputation. In a Feb. 28, 2005, e-mail reviewed by *BusinessWeek*, Dan Frazier, a Yahoo sales representative, torpedoed Oemtec's plan to advertise SpySpotter on Yahoo's Web site. "Unfortunately, it looks like we won't be able to run your ads on Yahoo!" he wrote. Attached to the e-mail was a link to a review by watchdog group Spywarewarrior.com, which calls SpySpotter "rogue/suspect anti-spyware."

Yahoo says that when it began its relationship with Oemtec in 2004, the smaller company complied with Yahoo partnership requirements. But now Yahoo is reviewing its tie to Oemtec, says Joshua Meyers, a senior director of the search engine's publisher network group. Meyers declined to comment on why ads on Oemji for U.S.-only companies generate clicks from Mongolia or Vietnam. He says Yahoo polices its partners and that a substantial number of suspect clicks are not billed to advertisers.

Oemtec calls the negative ratings of its products "patently and demonstrably false." Oemji Bar is similar to toolbars distributed by major online companies, and SpySpotter "is a legitimate and effective anti-spyware application," Craig Marcus, an attorney for the company, said in a Sept. 8 letter to *BusinessWeek*. Denying any involvement in click fraud, Marcus wrote: "Every single Oemji-generated click to MostChoice.com, and every other Web site, was and remains

legitimate and genuine." But he acknowledged that Oemtec "was alerted by advertisers in the past few months that certain foreign clicks were ineffective and undesirable." That prompted the company to stop displaying ads to users in Mongolia, Syria, and other countries, he said. Yahoo continued in September to supply Oemji with ads.

Sunbelt Software's Howes says the big search engine should rethink how it recycles advertising: "We just see [Yahoo] ads in too many places where they shouldn't be."

—Brian Grow



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# Mixing Business Travel with *Pleasure*

## Go for the Meetings, Stay for the Rest

For most people, business travel is an essential part of the job. For a few, it's a chore. For most, it's a perk. And for those intrepid souls who savor the chance to explore a new city and experience new cultures and cuisines, a business trip is also an excellent opportunity to sneak in vacation time in a time- and cost-effective way.

Adding a leisure component to a business trip is now a firmly entrenched trend. According to a survey by the National Business Travel Association (NBTA), 62 percent of U.S. business travelers add a leisure component to at least one business trip per year. Two-thirds bring family members or friends with them, according to an NBTA spokesperson. Globally, the trend is growing as well.

According to research from Barclaycard Business, 45 percent of business travelers "are actively trying to improve time spent

away by taking their partner on a business trip." Interestingly, men are more likely to take their partners along, with 49 percent doing so compared with 29 percent of their female counterparts.

So how can corporate travelers mix business and leisure?

■ **BRING THE KIDS.** School schedules — and corporate travel rules permitting, bringing kids along on your business trip is a great way to engage children, cut down on the kid's resentment that you travel so much, and simply have a lot of

fun together. In fact, many meeting and convention planners now organize kids' programs in the same way they plan spouse programs.

The success of bringing a child with you depends on the child's maturity, your ability to juggle the demands of work with the demands of parenthood, all while being in a city away from routines and support systems. Your choice of hotel matters, since many properties offer kids' menus, cribs, changing tables and potties, kid-size bathrobes, and such special touches as coloring books, activity kits and milk and cookies at tuck-in. Or book an all-suite hotel. That way the adult has a place to work while the children play. The kitchen in an all-suite hotel is a definite plus as well, since you can keep snacks handy and feed the kids more economically (and healthfully) than you could from room service.

For a new spin on day care, **Wyndham Ritz-Carlton** and **Hyatt** have camps at many resort and city hotels. Individual properties often have interesting children's programs as well. The **Peaks** at Telluride, for example, offers a "Kidspa Program" that includes hikes, swimming, yoga, gymnastics, panning for gold and snowman building.







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■ **STAY FOR THE WEEKEND.** Most business trips begin or end mid-week. By adding an extra day or two and tacking it onto the weekend before or after a meeting, you'll have a mini-holiday with one person's airfare already paid for.

One city that draws a disproportionate amount of this kind of add-on is New Orleans. Now that the tourism infrastructure has largely recovered from Katrina, the city is back to being a top draw for business-to-leisure trips. "The French Quarter, where virtually all leisure travelers stay, is on high ground, and wasn't affected by the flooding," explains Kim Priez, vice president of tourism for the **New Orleans Metropolitan Convention & Visitors Bureau (www.nomcvb.com)**.

Group bookings are strong, and Priez notes that business travelers have a new reason to stay after their business has concluded. "We're finding that many of our visitors don't just want to have a great vacation in New Orleans, they also want to help in the revitalization efforts by choosing to spend their vacation dollars here," she says. "That means staying and spending, on great food, great music, unique architecture and cultural attractions."

Priez also reports a huge burst in "voluntourism," a mix of sightseeing and charity work. The idea is resonating so deeply that the NOMCVB is creating a division to meet the demand. Meeting groups are especially interested in community service projects in which attendees

can participate — everything from rebuilding playgrounds and parks to working at Habitat for Humanity builds, she said.

■ **BOOK A LEISURE PACKAGE AND USE IT FOR A BUSINESS TRIP.** Many corporate travelers have learned this trick. They book a vacation package that bundles airfare, airport transfers, tours and hotel

"We're finding that many of our visitors don't just want to have a great vacation in **NEW ORLEANS**, they also want to help in the revitalization efforts by choosing to spend their vacation dollars here," Priez says.

room. The business traveler goes to work, skipping the tours while the significant other enjoys them. The cost for the package can be considerably below what you'd pay for airfare alone for a last-minute business trip. Also note: packages typically cost less for mid-week departures than weekend departures, while the opposite is true for business fares.

■ **USE YOUR CORPORATE TRAVEL AGENCY.** Professional travel counselors can advise on suitable properties, keeping in mind your kid's ages and interests; they'll know which airlines have special kids' programs and which airport lounges have special zones for younger travelers.

They'll also make sure the bookings for the business component of the trip are in compliance with your company's travel policy.

■ **LET YOUR HOTEL KNOW YOU WANT TO EXTEND YOUR BUSINESS TRIP.** Many hotels have incentive programs in place to encourage business-to-leisure stays. **Hilton Garden Inn®** is so devoted to this market that it created the Leisure Suit Traveler™ program to help guests extend weekday work into weekend fun. (Visit [www.LeisureSuitTraveler.com](http://www.LeisureSuitTraveler.com).)

■ **FIND LAST-MINUTE BARGAINS.** Going away on business with little advance planning? Use sites that specialize in last-minute arrangements, including [site59.com](http://site59.com), [lastminutetravel.com](http://lastminutetravel.com), [travelzoo.com](http://travelzoo.com), and [11thhourvacations.com](http://11thhourvacations.com). Other major online sites, such as Travelocity, have a last-minute packages tab on their home pages.

■ **PLAN A LAYOVER.** Connecting flights can be aggravating if you're in a hurry. However, they can be a blessing if you'd like to stop somewhere for a little R&R away from home — and far from your business-trip destination. If you live in New York and your meeting is in San Jose, plan a fun day or two in Chicago, Phoenix or Denver. If your significant other is joining you, that means less flying time for him or her. You don't necessari-







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## Exotic Business + Leisure Travel

ADTA (ABU DHABI TOURISM AUTHORITY)

One of the great joys of business travel is the chance to travel somewhere you wouldn't ordinarily go on your own. In the case of New Orleans, vice president of tourism Kim Priez says that most first-time visitors "come for a convention, fall in love with the Big Easy and return as a tourist when they have more time."

Global business travelers may have the same experience in destinations that are off the beaten tourist path but which offer extraordinarily rich travel experiences. A case in point is Abu Dhabi, capital of the United Arab Emirates (UAE) and the gateway for **Etihad Airways**, the national airline of the UAE. "When business travelers fly on Etihad, we make a conscious effort to provide them with a luxurious break from their daily routine," said Josephine Boulus, U.S. manager for Etihad Airways. "Etihad's Diamond and Pearl guest zones are equipped with a host of amenities such as a robust wine list, gourmet meals, and seats which transform to 180-degree flat beds. The flight is not just a means of getting from one place to another but an enjoyable experience in and of itself."

The experience continues when you land. Once a humble pearling village, Abu Dhabi is now a cosmopolitan city with lush green parks, fabulous shopping, and a Corniche with sensational views of the waterfront; the inner city boasts some of the finest architecture in the Middle East.

Also consider a day trip to Al Ain, the main town in the Buraimi Oasis, which lies on the border between Abu Dhabi and Oman. Its sister town, Buraimi, can be found on the Omani side of the border. The oasis may be the longest inhabited part of what is now the UAE, and settlements date back to the 4th Millennium BC.

Etihad will launch daily, non-stop flights between Abu Dhabi and New York on October 26, Boulus said. For more information, visit ([www.etihadairways.com](http://www.etihadairways.com)).

need to meet in a hub city; check with your company's preferred airline or your corporate travel agent to see how to build an itinerary with the flight-legs you need.

■ **USE DOWN TIME EFFECTIVELY.** Use free afternoons or unscheduled evenings to explore and/or unwind. Play nine holes of golf; take a walking tour; go to a museum or concert. James Lyndon, an airline executive turned loan officer, goes to the theater when he's on the road. "I've managed to stumble upon some very talented people in the most unlikely places," he said.

■ **USE YOUR MILES.** There's a certain justice when you use points and miles accrued on business trips – trips that eat up a lot of personal time – for leisure travel. A whole cottage industry has cropped up to help road warriors make the most of their frequency programs. These programs do vary, so be sure to read the fine print, and choose a program that offers flexibility and, if possible, no blackout dates.

**TripRewards** ([www.triprewards.com](http://www.triprewards.com)), for example, allows you to share your points with friends, or combine family members' points to earn rewards. Also,

you can redeem a free hotel stay at any time at any hotel with availability in the TripRewards network, including **AmeriHo Inn**<sup>®</sup>, **Baymont Inn & Suites**<sup>®</sup>, **Days Inn**<sup>®</sup>, **Howard Johnson**<sup>®</sup>, **Knights Inn**<sup>®</sup>, **Ramada**<sup>®</sup>, **Super 8**<sup>®</sup>, **Travelodge**<sup>®</sup> (U.S. hotels only), and **Wingate Inn**<sup>®</sup> hotels throughout the U.S. and Canada. TripRewards is the world's largest hotel rewards program, with over 6,000 participating hotels.

Be creative: you don't need to save your points for years to get that Hawaiian or Caribbean vacation for the whole family. Use your points for upgrades, or to bring a spouse or child with you on a domestic trip. TripRewards allows you to transfer your points not just for resort vacations, but for car rentals, airline tickets, as well as airline miles or rail points in your choice of participating programs – Air Canada Aeroplan<sup>®</sup>, Continental Airlines OnePass and Delta SkyMiles<sup>®</sup> – as well as Amtrak Guest Rewards<sup>®</sup>.

**BE CREATIVE:** you don't need to save up your points for years to get that Hawaiian or Caribbean vacation for the whole family.



**Writer:** Julie Moline is a business travel specialist and a frequent contributor to various consumer trade and in-flight publications.

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# How Business Is Wooing Democrats

The possibility the GOP could lose the House has companies scrambling to make nice



BY RICHARD S. DUNHAM AND  
EAMON JAVERS

**D**EMOCRATS ON CAPITOL Hill are reporting some unusual sightings in recent weeks: emissaries from the business world. Aides to Representative Charles B. Rangel (N.Y.), the top Democrat on the House Ways and Means Committee, got a call from executives of General Electric Co. seeking to get together to catch up. House Energy and Commerce Committee Democrats have been fielding requests for meetings with business lobbyists. And Republican-leaning companies including Boeing, KPMG, BP, HSBC, and Merck have signed on as top donors to the centrist New Democratic Coalition. "There's been a palpable shift in outreach to Democrats by business lobbyists, and trade groups," says Representative Adam Smith (

## LOBBYISTS

### They May Be the Go-To Guys Again

**D**EMOCRATIC LOBBYISTS WOULD BE IN A GREAT position to profit if Democrats wrest control of either chamber of Congress from Republicans in the midterm elections. But lobby shops and businesses aren't waiting until election results roll in. Lobbyists with strong ties to key congressional Democrats are already in hot demand, and their stock would shoot even higher if the Dems win in November. Of course, lobbyists of both parties seek similar advantages for their clients: tax breaks, relaxed regulation, and the like. But a lobbyist's relationship to those in the majority can make a big difference. Here are some K Street players poised to cash in on a Democratic surge:



## Former Staffers

### DAVID CASTAGNETTI

Mehlman Vogel Castagnetti

Castagnetti, 45, worked on John Kerry's 2004 Presidential campaign and was chief of staff for Senator Max Baucus (D-Mont.) who would chair the Senate Finance Committee if the Democrats win the Senate. Clients include PhRMA and PepsiCo.



### STEVE ELMENDORF

Bryan Cave Strategies

Elmendorf, 46, was a senior adviser to House Democratic Leader Dick Gephardt for 12 years and deputy campaign manager for Kerry's 2004 Presidential run, among other political jobs. His clients include Shell Oil and Ford.



sh.), New Democrats' co-chair. Laughs  
angel: "I have a lot of new friends."  
With the 2006 midterm elections  
ring and the Republicans receiving  
ord-low approval ratings from the  
merican public, companies and busi-  
groups are reaching out to opposi-  
leaders in anticipation of a possible  
nocratic takeover of the House of Rep-  
entatives, or even a Democratic sweep  
ongress for the first time in 14 years.

## TER DONATIONS

INNESS LOBBYISTS have scrambled to  
nsor fund-raisers for Democratic Sen-  
s Christopher J. Dodd of Connecticut  
Patrick J. Leahy of Vermont, who are  
up for election this year but are in line  
ecome key committee chairs if Demo-  
s seize control of the Senate. House  
ority Leader Nancy Pelosi (D-Calif.),  
has a 24% lifetime approval rating  
in the U.S. Chamber of Commerce, has  
ched her contributions from business  
tical action committees jump 31%  
the same period in the last election  
e, according to the nonpartisan Cen-  
or Responsive Politics. Even Repre-  
ative Barney Frank, the sharp-  
qued Massachusetts liberal in line to  
over the House Financial Services  
mittee, has seen a 35% increase in  
donations from corporate interests.  
ne corporate Establishment hasn't  
enly shifted left. But just as business  
ps played ball with House Democrats  
ng that party's 40-year run, through-  
e, companies are once again showing  
are prepared to deal the best they can  
the people in power. "It's a very safe

assumption to say that De-  
mocrats are more popular  
than they have been recently,"  
says Bernadette A. Budde of the  
Business Industry Political Action  
Committee. "I don't think you can be  
a mainline industry and just work one  
side of the aisle." Indeed, many com-  
panies touching base with Dems  
say they always have lines out to  
both parties. "We fail to main-  
tain contact with them at our  
own peril," says a GE lobbyist.

The newfound popularity  
of Democrats can be seen in  
the giving patterns of  
dozens of corporate  
PACs. Most business  
groups remain firmly  
Republican in their  
outlays, but a dozen  
have shown signifi-  
cant shifts toward  
the out party. The  
PAC of retail chain  
Target Corp. has  
increased its dona-  
tions to Democrats  
from 23.5% in the 2004  
election to 41.6% this year,  
through July 31 according to the  
nonpartisan PoliticalMoneyLine.com.  
The Democratic share of Intel Corp.'s PAC  
contributions jumped from 22.5% to  
35.1%, and Wal-Mart Stores Inc.'s Demo-  
cratic contributions rose from 22.1% to  
32.1%. "The business community is first  
and foremost practical," says one former  
Republican Cabinet member who is now a  
lobbyist, "and they will cover their butts."



Driving the out-  
reach is polling that  
shows congressional De-  
mocrats are in fighting shape  
for the first time in years. Infl-  
uenced by frustrations in Iraq,  
wages that haven't kept pace with in-  
flation, and the response to Hurricane Ka-  
trina, voters say they prefer Democrats to  
Republicans this year. A survey by the Pew  
Research Center for the People & the Press  
conducted Sept. 6-10 found that voters fa-  
vor the Democratic congressional candi-  
dates in their districts by 50% to 39%. The  
Democrats' chances are best in the House,  
where Republicans hold a 231-201 edge,



## Party Bigwigs

### TONY PODESTA

PodestaMattoon

Podesta, 62, heads Pennsylvania Governor  
Ed Rendell's reelection campaign and  
earlier led the Pennsylvania Presidential  
campaigns of Clinton in 1996 and Kerry in  
2004. Among his clients: Novartis Vaccines  
& Diagnostics and Tyco International.



### MIKE BERMAN

The Duberstein Group

Berman, 67, is a K Street veteran who has  
worked on every Democratic Presidential  
campaign since 1964. He was also a  
counsel to Vice-President Walter Mondale.  
Berman's clients include BP, Comcast, and  
Goldman Sachs.



## Former Members of Congress

### VIC FAZIO

Akin Gump Strauss Hauer & Feld

Fazio, 63, is a former Democratic  
congressman from California. He sits on the  
board of directors of defense contractor  
Northrop Grumman, and he represented  
China National Offshore Oil (CNOOC) in its  
failed bid to merge with Unocal.



### JOHN BREAU

Patton Boggs

Breaux, 62, was one of the most  
conservative Democrats in the Senate and  
often served as a bridge between  
conservatives and liberals in Capitol Hill  
negotiations. Clients include the U.S.-India  
Business Council and the Louisiana State  
Economic Development Agency.



with two vacant seats, and an independent who votes with Democrats. They need to gain 15 seats to control the chamber. They need a 6-seat shift to gain the majority in the Senate—less likely, but not impossible.

## TALKING SOFTER

ALREADY, HOUSE Minority Whip Steny Hoyer (D-Md.), a pro-business moderate, has been trying to reassure corporate lobbyists that a Democratic majority would not result in an orgy of business-bashing. Rangel, the would-be chair of the House tax-writing committee, says he also hopes to unite business lobbyists and committee members of both parties on such issues as trade, tax reform, and education. "If we fight for two years, Democrats won't be able to get a damn thing done," he says.

Republican-leaning businesses say the stream of contributions to Democrats would become a torrent if Democrats prevail. Conservative activists are not amused by the new bipartisanship. "It comes across as unprofessional," says Grover G. Norquist, president of Americans for Tax Reform. "The AFL-CIO doesn't shift its giving when Republicans come to power. They give to people who agree with them."

Meanwhile, the street value of Democratic lobbyists is surging. According to one recruiter, a well-connected Democratic lobbyist can boost his or her pay by more than \$100,000 by jumping to a firm looking to beef up its Democratic bona fides. "A lot of people are saying, 'Oh, my God, the House may be Democratic-controlled, and who do we have who would have a relationship with the committee chairs?'" says former Senator John Breaux (D-La.), a pro-business Democrat now with the Patton Boggs law firm.

This spring the all-Republican lobbying shop Federalist Group, whose clients include the American Trucking Assn. and Viacom Inc., hired Democratic lobbyists for the first time, including former Representative Chris John (D-La.). Says managing director Wayne L. Berman, a veteran GOP operative: "We are positioned to represent our clients' interests to key House leaders in either party."

Democratic lobbyist Tony Podesta of the bipartisan firm PodestaMattoon says he was surprised to land three new clients in August of an election year, a time when companies are more likely to cancel contracts than to sign them. Podesta says one client recently bragged that his company leads its industry in contributions to Democrats. "That was a conversation," he says, "that would have been unimaginable a year ago." ■

—With Dawn Kopecki in Washington

## PAYBACK TIME

# Who Might Be on The Democrats' Hit List

**W**hile some businesses step up their romancing of Democrats who might take over the House of Representatives, other companies and industries have real reason to worry. With a majority in the House, Democrats would set the legislative agenda, convene hearings, and launch investigations—powers they have lacked for a dozen years.

Democrats already have several industries and companies in their sights.

Defense contractors—Halliburton Co. in particular—are at the top of the list for allegedly overbilling the federal government billions of dollars for reconstruction work in Iraq. Halliburton has not been charged with wrongdoing, and it has said many of its cost overruns stem from the exigencies of working in a war zone. A company spokeswoman says Halliburton has worked well with Administrations of both parties and that it will continue to cooperate with federal overseers.

That won't appease Representative Henry A. Waxman (D-Calif.), political analysts say. If Democrats prevail in November, Waxman, a vocal Halliburton critic, would chair the Government Reform Committee that oversees Iraq contracting matters.

Pharmaceutical companies will likely come under fire for securing a provision in the 2004 Medicare drug plan that prohibits the government from negotiating discounts on prescription drugs. Democrats say the measure has been a windfall for Big Pharma. PhRMA, the industry's trade group, declines comment.

Representative Edward J. Markey (D-Mass.), who sits on the House Energy & Commerce Committee, says a key goal if his party wins will be to get "a fair price" from companies that pay little or no royalties to the government on oil and gas extracted from federal lands.

Oil company executives may again be called to Capitol Hill to answer questions about alleged price gouging. Exxon Mobil Corp., which booked record profits recently, is of particular interest to Democrats. ExxonMobil spokesman David Gardner says the criticism is unwarranted. He notes that over the past three decades the company has repeatedly been cleared of all such allegations.

—By Dawn Kopecki



## HOT SEAT BOUND?

These industries may have reason to worry if Democrats prevail in November

**1 DEFENSE CONTRACTORS** Reports of fraud and abuse related to Iraq and Hurricane Katrina will keep contractors on the hot seat

**2 ENERGY** Democrats think oil and gas companies aren't paying their fair share of drilling royalties

**3 PHARMACEUTICALS** Profits from the Medicare drug plan are likely to be scrutinized

**4 STUDENT LENDERS** Democrats plan to take another look at a congressional deal that raised interest rates for student loans



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# A Hot IPO Market For Boutique Banks

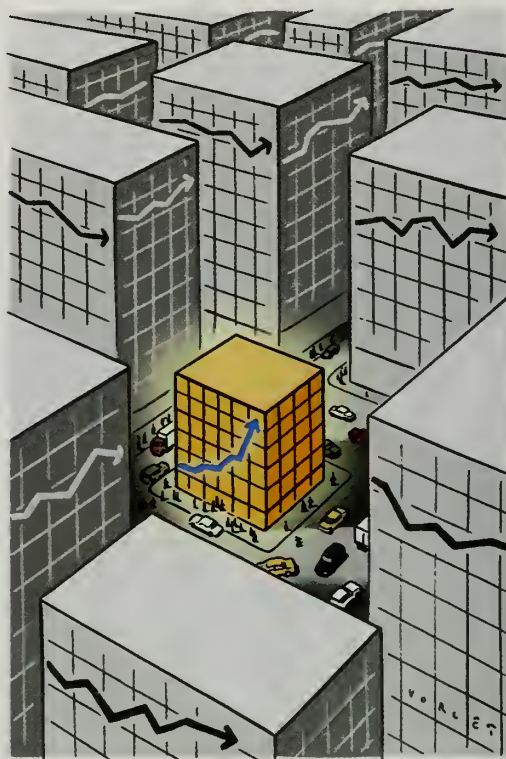
As small firms grab M&A business, they are making themselves more appealing to investors

BY AARON PRESSMAN

**B**OUTIQUE INVESTMENT bank Keefe, Bruyette & Woods Inc.'s first two attempts to go public in the late 1990s were quashed by Russia's debt default and an insider-trading scandal involving the then-chief executive officer and a porn star. Now the New York firm is back. And this time, the stock market's infatuation with niche banks that focus on mergers and acquisitions ought to make for a successful debut.

KBW announced its initial public offering in August, hoping to capitalize on the investing zeitgeist that has sent offerings of other boutique investment banks soaring. The most recent IPO was that of Evercore Partners Inc., a 10-year-old group founded by Roger Altman, Deputy Treasury Secretary under President Bill Clinton, and Austin M. Beutner, a former general partner of The Blackstone Group. Its roster of blue-chip clients such as AT&T Inc. rivals that of any Wall Street firm. Evercore's shares have jumped 44% since its Aug. 11 initial offering. Other boutiques have pulled off similar successes, handily beating the 4% gain for IPOs overall this year (table). The small energy specialist Petrie, Parkman & Co. became the latest to file for an IPO, on Sept. 13.

What's stoking investors' enthusiasm?



The small guys are stealing market share from their larger brethren—frequently the very firms where today's specialty bankers got their start. The big, diversified firms, hit with a bevy of investigations and restrictions over conflicts of interest in recent years, increasingly rely on their trading

desks for profits. That leaves fewer resources for the traditional hand-holding that builds long-term investment-banking relationships. Evercore, Lazard, and Greenhill advised on mergers and acquisitions deals

totaling 28% of this year's \$874 billion through August, up from 18% last year according to Thomson Financial. KBW share doubled, to 3.6%, last year when advised Bank of America on the \$35 billion MBNA acquisition, though it has fallen back to 2.6% so far this year.

Meanwhile, the combined market share of Goldman Sachs Group, Morgan Stanley, and Merrill Lynch is running 77% through August, vs. 94% in 2005. "There has been a brain drain out of Wall Street," says Frederick C. Lane, CEO of Boston boutique Lane, Berry & Co., which he formed after working at Credit Suisse First Boston.

Founded in 1962, KBW devoted nearly all its attention to the banking, insurance, and brokerage industries, which are awash in consolidation-driven mergers. That specialization has helped drive revenue up 50% in the first quarter, to \$101 million, while net income tripled, to \$10 million.

## KEEPING CLOSE

KBW HAS PROSPERED mainly by focusing on midsize deals and cultivating relationships with hundreds of institutions ignored by the rest of Wall Street. In a typical transaction, KBW advised Fidelity Bancshares Inc., a small Florida bank, on its \$1 billion sale to National City Corp. National City CEO David A. Daberkow credited KBW for bringing the deal to bank. "They've built up these relationships over time," he says. "The big firms haven't been as successful on doing that."

The merger mania in financial services shows no sign of slowing. Back in 1999, KBW's IPO filing said the industry's consolidation was "far from complete," given the existence of 10,000 banking institutions. The new filing notes that 7,000 remain. "I don't know what the final number [will be], but it's a lot less," says Andrew Schutz, manager of the Burnham Financial Industries Fund. KBW declined to comment, citing the quiet period of IPO filings.

The market's love affair with niche banks may be short-lived, since such niche players are by nature less diversified. For example, slow times for technology offerings have weighed on recent IPOs of Cowen Group Inc. and Thomas Weiskopf Partners Group Inc. Still, all the dealmaking in financial services bodes well for KBW—and its new shareholders. ■

## Riding the Merger Wave

Boutique investment banks specializing in M&A have outperformed tech-focused banks

| M&A BANKS     | IPO DATE | CHANGE IN STOCK PRICE* |
|---------------|----------|------------------------|
| Evercore      | 8/11/06  | 44%                    |
| Lazard        | 5/04/05  | 59%                    |
| Greenhill     | 5/06/04  | 244%                   |
| TECH BANKS    |          |                        |
| Thomas Weisel | 2/02/06  | 11%                    |
| Cowen Group   | 7/13/06  | 5%                     |

\*From IPO to 9/19/06 Data: BusinessWeek



# Hitting the Nail on the Head—Lightly

How union leader Ed Durkin is pushing to reform corporate behavior

BY NANETTE BYRNES

**E**D DURKIN IS A THIRD-generation union leader, the son and grandson of steamfitters, and he has been a force in blue-collar unions for more than 20 years. But you wouldn't know it by looking at him. His crisply pressed suit is the first hint that Durkin doesn't easily fit preconceived ideas. That seems to be part of what makes him so effective as the director of corporate affairs at United Brotherhood of Carpenters, overseeing investments for the union's \$40 billion pension funds. Not only has he been early to spot important corporate governance reforms and push for them, but he has also often been able to get companies to see things his way. Durkin's most recent campaign: Convincing 70 corporations that their directors should be reelected by a majority of shareholders—or resign.

Durkin has often been out in front of major corporate governance issues. He's a thinking leader and a catalyst for reform," says Peter Gilbert, head of investments at the Pennsylvania State Employee's Retirement System. *BusinessWeek* writers sat down with Durkin for a mid-September lunch of crab cakes at Charlie Palmer Steak in Washington, during which Durkin dug into the issues of the day, from hedge fund activism to efforts to weaken the controversial Sarbanes-Oxley corporate governance rules.

**Shareholder activists hail you as a leading investor advocate, but you're more self-critical. Why?**

"Workers' stock ownership is an important source of influence and power. But I don't know if we've done that good a job of using it. We've made progress, but in some ways I think we've sort of stalled. Take the recent [H.J.] Heinz situation. [Investor] Nelson Peltz takes a 6%, 6% position in Heinz and ends up with two people on the board. Worker pension funds in this country have tril-

lions of dollars. I don't mean to say it should all translate into board seats, but maybe we haven't effectively utilized that to secure a greater say in the governance of these companies.

**You argue that labor should be viewed as a long-term investor.**

The view of shareholder activism that has won out so far is the short-term approach. But there should be a broader view. We have stock in 3,500 companies, and we have a different investment horizon [from hedge funds and other short-term investors].

**In September a group of business thinkers formed to update Sarbanes-Oxley. What's your reaction?**

Given the state of disarray in corporations, [Sarbox] was a good reform. Pushing back at that is problematic. Obviously there's a cost to [Sarbox]. But spending money on things has not always been a problem for boards.

## Corporate Gadfly

As the carpenters' union's corporate affairs director, Durkin has pushed companies to:

- Expense stock options, helping to pass the current new rules
- Change the way directors are elected at more than 70 companies
- Publicize how much auditing firms were paid as consultants, a conflict exposed at Enron

Data: BusinessWeek

**Like CEO compensation, for example.**

Executive pay is one of the most frustrating issues. It's like the [whack-a-mole] carnival game where you hit one and [another] pops up.

**Do situations like the one at Hewlett-Packard make you worried that companies still aren't run properly?**

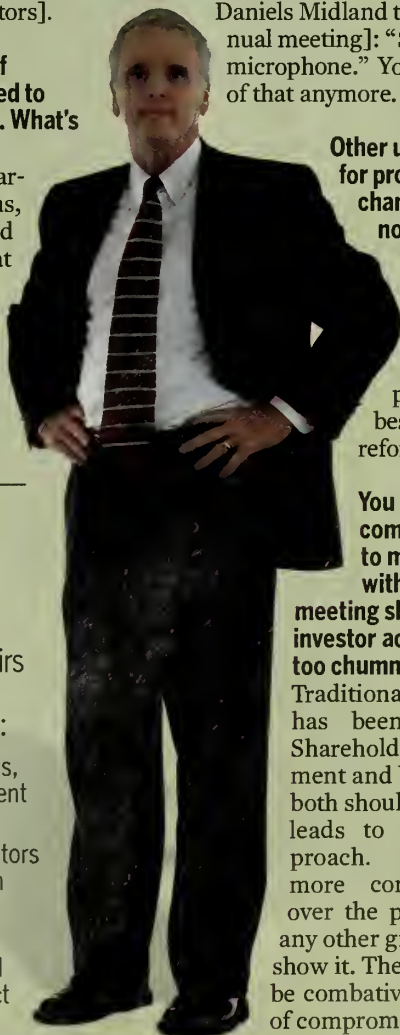
You can't legislate against stupidity. We can come up with 10 examples where boards are not working, but there is greater accountability [today]. I remember Dwayne Andreas at Archer Daniels Midland telling me [at an annual meeting]: "Sit down. I own this microphone." You don't have much of that anymore.

**Other unions are pushing for proxy access—the chance for investors to nominate directors. Why aren't you?**

It's the hedge funds that will use it. Free riding on the company's proxy is not the next best step in election reform.

**You usually work with companies to get them to make changes without an annual-meeting showdown. Do other investor activists think that's too chummy?**

Traditional investor activism has been narrow-minded. Shareholders want management and boards to look over both shoulders. We think that leads to a short-term approach. We've prompted more constructive reform over the past six years than any other group. The numbers show it. The labor instinct is to be combative, but it's also one of compromise. ■





# Sun: Out from Behind the Clouds

New CEO Schwartz is drawing raves for the company's growth spurt, but can it last?

BY STEVE HAMM

**T**ECH INDUSTRY MAVENS had their doubts about Jonathan I. Schwartz when he was promoted to chief executive of Sun Microsystems Inc. in April, replacing longtime CEO Scott McNealy. There was the ponytail, which helps Schwartz look a lot younger than his 40 years. He also has a brash style that seemed to be out of sync with Sun's grim realities. Did this Web 2.0 CEO have enough gravitas to run a struggling computer company?

It didn't take long for Schwartz to show his stuff. Sun, which had fallen far from its perch as one of the highfliers of the dot-com era, has emerged from a five-year funk to turn in two strong quarters of revenue growth and market share gains. The stock has shot up 38% since late July, and Schwartz looked golden while making the rounds of Wall Street and New York customers in early September. "We think Sun is on the way to turning around," says analyst Ben Reitzes of UBS, who recently upgraded the stock.

Schwartz is working hard to convince outsiders that Sun has shifted its core competency. His message: Sun isn't just about fast servers anymore. Now it emphasizes technology that saves customers money on electricity and yields more processing power for the buck. Schwartz wants to capitalize on the growth of consumer-driven markets, such as retail banks, telecom companies, and big Internet companies. "They're betting on the Internet to drive growth in their business," he says. "If you bet on the right customers, like



## BRINGING SUN AROUND



**SCHWARTZ** Sun has successfully competed on price. Now it must focus on higher-margin servers

we are, you can grow much faster than the marketplace." It helps that Sun has refreshed all of its major product lines in the past year.

Customers like the new computers because they're cheaper and help them pack more power into crowded data centers. Joyent Inc., a seller of e-mail and storage services delivered to customers over the Net, switched from Dell servers to Sun

machines last year. When all factors were taken into account, the Sun computers were no more expensive and, over time, allowed Joyent to save money. "We have been conditioned to think of Sun as a high-priced alternative, but it's not," says Joyent Chief Executive David P. Young.

Sun's turnaround is far from a done deal, though. While revenues grew 2% last quarter, the company is still losing a pile of money. Its \$301 million net loss in the fourth fiscal quarter ended June 30 included \$228 million in restructuring charges. And while Sun's share of the computer server market increased 12.9% in those three months, it's still

well below a peak of 16.7% in late 2000, says market researcher IDC. "I don't see this as sustainable," says David V. Gerard, vice-president at IDC, which leads server sales with a 31% share. One thing, Sun has shown up in the market for so-called blade servers, densely packed machines that are increasingly popular in large corporations.

## MORE R&D

MUCH OF Sun's growth has come in inexpensive servers powered by advanced Micro Device Opteron chip. It's a low-margin business. Sun's challenge is to keep the high level of investment needed to fund development of its chips and high-performance servers. The company spent \$2 billion on research and development last fiscal year, or 15.5% of revenues. Dell spends 1% on R&D. Analysts

say Sun will have to rev up software to strengthen margins.

One indicator to watch is how customers warm to Sun's Solaris operating system. It distributes an open-source version to try to win converts, Schwartz reports that 70% of the software packages have been loaded on Dell, IBM, and Hewlett-Packard computers. If Sun can persuade those customers to buy Solaris licenses and, ultimately, switch to its hardware, a sustainable turnaround may be on the way. ■

# The sky is the limit

A smiling man with dark hair and a light beard is in the foreground, looking towards the camera. In the background, the tail fin and wings of a large Airbus A380 are visible against a blue sky. Two ground crew members in high-visibility vests are standing on the tarmac in the distance.

The groundbreaking new Airbus A380 is the world's largest passenger jet. While at the same time setting new standards for fuel efficiency and quiet operation.

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# The Man Behind a Greener California

John Doerr's fight for a clean energy bill is good for the climate—and his investments

BY JUSTIN HIBBARD

**I**N AUGUST, THE CALIFORNIA legislature passed a landmark bill to limit greenhouse gas emissions in the Golden State. If Governor Arnold Schwarzenegger approves the bill, as expected, it will be one of the most aggressive state efforts to combat global warming. What few Californians may realize is that the bill might have died on the floor without the energetic support of L. John Doerr, partner at Silicon Valley venture capital firm Kleiner Perkins Caufield & Byers. Doerr and his cohort of green-leaning VCs may be steering California in a desirable direction. Still, it riles Doerr's critics that if it becomes law the bill could put his companies a helping hand.

From the beginning, this legislation was politically risky for lawmakers and investors alike. Energy companies loathed it, and few businesspeople had come to its defense. Then, two weeks before the vote, Doerr and the top executives from several alternative-energy startups visited legislators at the state capitol and held a news conference in support of the bill. A week later, it had all the votes required.

Lawmakers who signed on after Doerr's visit say his group's endorsement made the difference. And that's no surprise given his track record in business. Since 1980, Doerr has sunk millions of dollars into startups such as Amazon.com, Google, Intuit, and Sun Microsystems. He's watched the stakes multiply hundreds of thousands of times. "The fact that a portion of the business community saw benefits to [this bill's] passage was a significant factor in my decision," says Assembly member Juan Arambula, a Democrat from Fresno who supported the bill.

**GREEN  
Biz**

## "POLICY MATTERS"

AS DOERR AND HIS colleagues expand their investment portfolios beyond tech into heavily regulated fields such as energy and stem-cell therapies, they're contributing money, time, and powerful contacts to political causes that match their beliefs—and reward their investments. "Policy matters, and we will be active in policy," Doerr said in May at KPCB's Cleantech Venture Network conference in San Francisco.

In addition to backing the new global warming bill, which could be signed within a matter of days, Doerr and former K



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partners Vinod Khosla and William Randolph Hearst III have donated almost half of the \$4.4 million raised to pass Proposition 87, another environmental initiative that will be on the November ballot in California. Prop 87 would impose a tax on oil production in the state and use the proceeds to finance a \$4 billion alternative-energy research program.

Actions like these draw plenty of criticism—and Doerr is used to it. In 2004 he and several other VCs pushed for a California Ballot initiative called Proposition 71. The legislation, which 59% of California voters approved, created a committee of political appointees to dole out \$3 billion to California stem-cell researchers. Venture-backed startups will eventually be able to license and commercialize the taxpayer-funded research, just as they would be able to do with energy research funded by Proposition 87. That has caused opponents of the energy measure to cry foul. “The proponents stand to make a financial gain from its passing,” says Jon Coupal, president of the conservative Howard Jarvis Taxpayers Assn. “That we find offensive.”

Doerr concedes that Proposition 87 could help some startups in KPCB’s portfolio, but says that those companies don’t need a new law to thrive. “The ventures are going to do very well with or without this legislation,” he said in an interview with *BusinessWeek*. Furthermore, the bill will boost California’s economy by helping to generate a new alternative-energy industry in the state, he says. A recent study by a panel of California state agencies predicted that building renewable energy infrastructure and battling climate change would create 83,000 jobs and \$4 billion in income in the state by 2020.

## VOLATILE MARKET

ALTRA INC., a Los Angeles ethanol producer that has raised \$183 million from KPCB and other investors, says it has already created many jobs. In July the company acquired California’s largest ethanol plant, which is in Goshen, a town in the state’s agricultural San Joaquin Valley. “It took hundreds of people to build that plant,” says Altra Chief Executive Larry Gross, who stumped for California’s new global-warming bill with Doerr at the capitol in mid-August. “Certainly, we have the self-interest that [the bill] will benefit our company,” he



**“The ventures are going to do very well with or without this legislation”**

JOHN DOERR

says. “But it will benefit a lot of other businesses and consumers.”

Doerr says the overall green-energy market is “probably the largest economic opportunity of the 21st century.” Since 2001, KPCB has committed \$200 million to at least nine energy startups. Ion America Corp. in Sunnyvale is developing a solid oxide fuel cell that can supply electricity to commercial buildings and residences. Amyris Biotechnologies in Emeryville is creating genetically altered microbes that excrete fuel. And Miasole in Santa Clara prints solar cells on thin plastic sheets.

To Doerr, alternative energy is an investment theme on the scale of the Internet. Of course, such markets are given to

volatile cycles of hype, disillusionment and rebound. After a bull run that began last year, alternative-energy stocks have recently fallen along with the price of oil, which, when low, makes alternatives less attractive. In mid-September, ethanol producer Hawkeye Holdings postponed its initial public offering, citing market conditions. The stocks of two other ethanol makers, Aventine Renewable Energy Holdings and VeraSun Energy, are down 42% and 48%, respectively, since peaking in June.

Undaunted, Doerr has set his sights beyond California. In Washington, KPCB partner emeritus E. Floyd Kvamme serves as co-chair of President George W. Bush’s Council of Advisors in Science & Technology, giving the venture firm access to the White House. “We worked to get the notion of oil addiction and cellulosic ethanol into the President’s State of the Union address,” Doerr told reporters at a May conference. Bush’s famous warning that “America is addicted to oil,” and his reliance on ethanol made from switchgrass came partly from Doerr and his partner through Kvamme.

KPCB also maintains close ties to the U.S. Congress. In the past year, Doerr and his partner have discussed energy policy with Senators Richard Lugar (R-Ind.) and Democratic Senators Barack Obama of Illinois and Joseph Lieberman of Connecticut. The firm has worked to pass a bill sponsored by Lieberman and Arizona Senator John McCain that would set limits on greenhouse gases and let businesses trade emissions credits through a market-based system.

“We believe in market-based solutions,” Doerr told attendees at KPCB’s May conference. He explained his support for such a trading system. “My approach to green politics reflects this faith. Critics accuse Doerr and his associates of self-serving politics, but I readily forgive them as long as the startups they fund build a clean, inexpensive energy future for Californians. But as the market waits for the payoff from investment, it could run quite a bill. ■

—With Christopher Pal  
in Los Angeles

## VCs On a Mission to Cut Emissions

### ALTRA

- Developing assets to produce ethanol and bio diesel
- \$183 million invested by Kleiner Perkins Caufield & Byers (KPCB), Khosla Ventures, Angelino Group, Omnicor Capital, Sage Capital Partners, Duff Ackerman & Goodrich, Advanced Equities

### ION AMERICA

- Developing a solid oxide fuel cell to power buildings
- \$165 million invested by KPCB, New Enterprise Associates, Mobius Venture Capital, Advanced Equities

### AMYRIS BIOTECHNOLOGIES

- Researching microbes that produce alternative fuel
- \$6.5 million invested by KPCB, Khosla Ventures, Texas Pacific Group Ventures

### MIASOLE

- Manufacturing lower cost thin-film solar cells
- \$21 million invested by KPCB, VantagePoint Venture Partners, Garage Technology Ventures, Firelake Capital Management, Nippon Kouatsu Electric Co.

### GREATPOINT ENERGY

- Commercializing process to convert coal to natural gas
- \$36.5 million invested by KPCB, Draper Fisher Jurvetson, Advanced Technology Ventures

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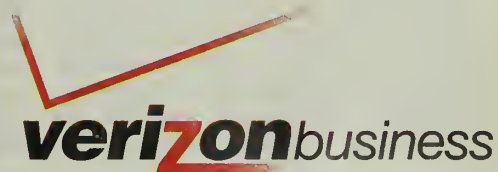
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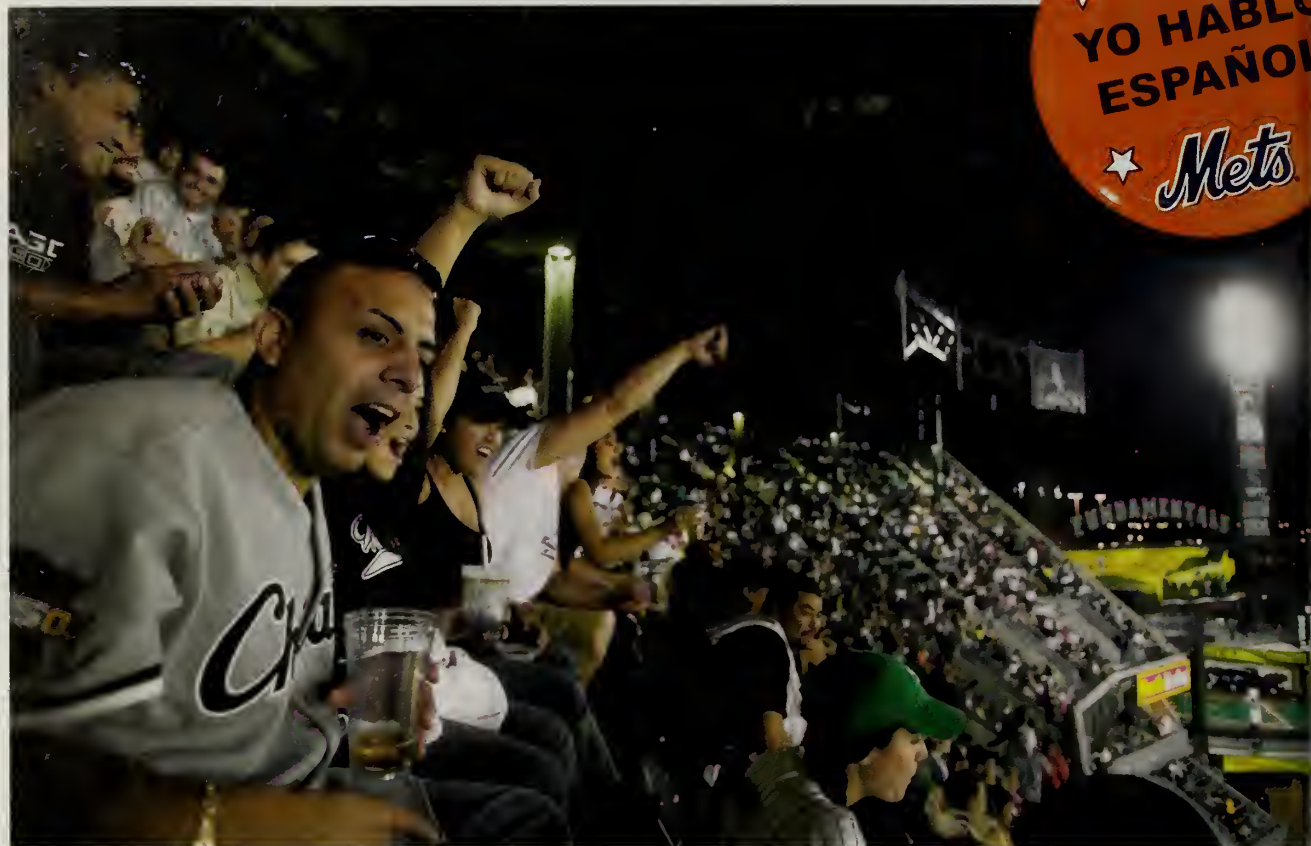
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# The Racial Gap In the Grandstands

Major League Baseball is aggressively courting Latinos as African Americans drift away

BY MARK HYMAN

INSIDE THE MAIN GATE OF ANGELS Stadium, home of the Los Angeles Angels of Anaheim, an eye-catching sign directs fans to the *Tienda Del Equipo* (aka team merchandise store). But it's more than a mere sign. It's a sign of the times.

As Major League Baseball sails toward another attendance record this season, Latino fans are turning out in large numbers to cheer on the game's growing cadre of Latino stars. And they're being aggressively courted with everything from Spanish-language Web sites such as [loswhitesox.com](http://loswhitesox.com) to Cuban sandwiches at the New York Mets' Shea Stadium.

What makes MLB's skillful wooing of Latino fans so fascinating is how starkly it differs from the sport's failed efforts to engage African Americans. Once blacks were among MLB's most die-hard fans, as MLB commissioner Bud Selig is fond of recalling. Selig revels in a childhood memory of sitting with his friend Herb

**A BILINGUAL GAME**  
More MLB teams are translating ads and signage into Spanish

Kohl (now a Democratic Senator from Wisconsin) at Chicago's Wrigley Field in May, 1947. "As I looked around I remember saying: 'My God, we're the only white people in the upper deck,'" Selig says.

Nearly 60 years later, blacks are vanishing from big-league seats—big-league fields. Black players held 9% of roster spots in 2005, down from 18% in 1991. It's trickier to track black fans, because MLB doesn't keep counts. Scarborough Sports Marketing, based in New York, puts African American turnout at MLB games at 8% of total attendance. That's puny considering that blacks constitute 13% of the U.S. population and more than a third of MLB teams are located in metro areas where blacks make up 25% or more of residents, according to 2000 U.S. Census data.

This tale of two minorities partly

**WHITE SOX FANS**  
at U.S. Cellular Field's Latino College night

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**ANGELS** Fin de Semana de día Memorial

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DVD de los Angeles de la Temporada 2005 para todos los miembros de la familia

MAYO 28 VS ORIOLAS DOMINGO • 12:35 PM  
McDonald's FAMILY GUY Peliculas de Caras y Artistas de Béisbol para Niños

MAYO 29 VS TWINS LUNES • 6:05 PM  
Piróteknicos DEL DIA MEMORIAL

BOLETOS 714-663-9000 \$9 POR ADULTOS Y \$5 POR NIÑOS ticketmaster o VISITE [angelbaseball.com](http://angelbaseball.com)



s cultural forces that MLB couldn't anticipate. In black communities, baseball fell victim to "the perfect storm," says MLB Executive Vice-President Jim Lee Solomon. He cites the shrinking number of baseball diamonds in inner cities over several decades and the rise in popularity of football and basketball, which youths see as easier stepping stones to college scholarships and pro careers—partly because baseball requires a apprenticeship in the minor leagues. Latinos, on the other hand, have proved comparatively easy sell. Fans with roots in Latino nations make up 13% of big-league attendance, according to Scarborough. And they're not just cheering at the ballpark: The number of Latinos who watch baseball or listen on the radio is up about 15% since 2001.

Many of these aficionados brought a love of baseball with them from places like the Dominican Republic and Puerto Rico, places that also are pipelines for MLB players. Latinos now hold 29% of big-league positions, a record, up from 14% in 1991, according to the University of Central Florida's 2005 Racial & Gender Record. And many, from the Cardinals' Albert Pujols to the Mets' Carlos Beltrán and Carlos Delgado, are major stars.

The growing Latino audience has big-league teams fishing for new customers. This season 17 teams, including the Kansas City Royals and Milwaukee Brewers, held Latino heritage celebrations. Corazón America is tuning in, too. On Sept. 2, Coca-Cola and Toyota treated about 100 gyrating Los Angeles Dodgers fans with a Los Dodgers, a Latin dance party in the parking lot outside Dodger Stadium. "If you go to a Major League game anywhere, you see the same [Latino] influence. There's a more global flavor in who's playing and who's coming to watch," says Mets General Manager Omar Minaya.

What's missing, however, is many African American faces in the stands. One interesting aspect of that phenomenon is how little MLB seems to know about it—including when the exodus started and how many blacks drifted away. One of the few stats that does track attendance of minorities, the Chicago White Sox, says a mere 5% of fans coming through the turnstiles are black—in a city with an African American population of 37%.

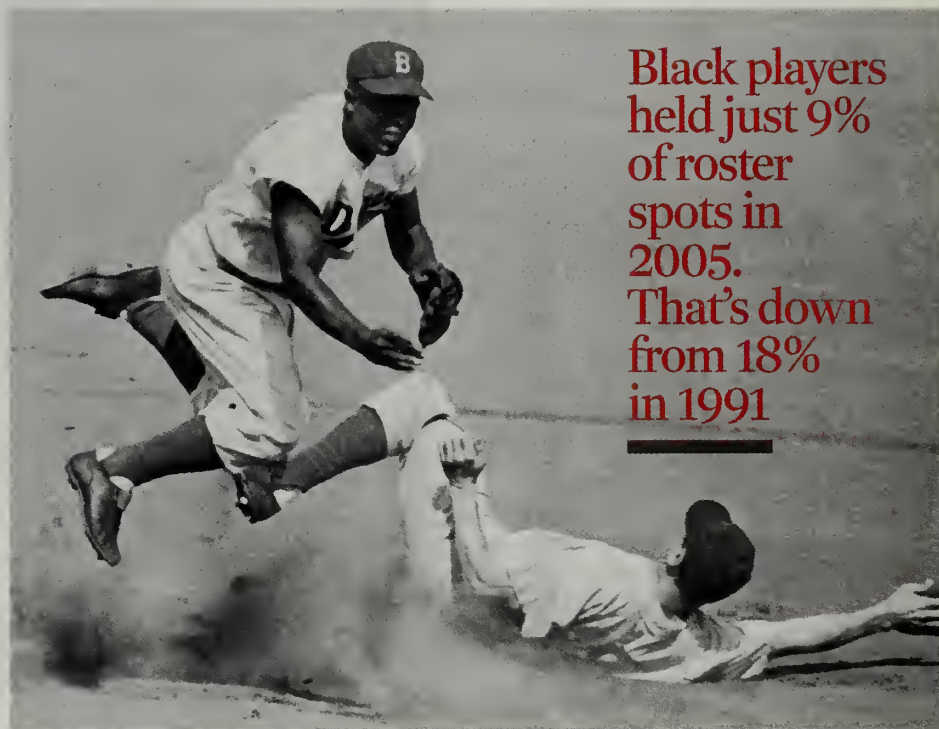
That frustrates White Sox owner Jerry Reinsdorf, who bought the team in 1981. It's unusual for having put in place a good manager, Ozzie Guillén, and an African American general manager, Ken Williams. The standard explanations offered for low turnout among blacks—high

ticket prices, MLB's failure to have even one franchise owned by a black investor, inadequate marketing—don't impress Reinsdorf. He says in the decades he has owned the White Sox and the Chicago Bulls of the National Basketball Assn., blacks have never turned out for either team in big numbers. He attributes it to another factor: "For whatever reason, the African American community seems to participate in sports but not watch them. Maybe they are smarter than the average person. Maybe there is something in the black culture that tells them: 'I don't benefit when the Cubs win or the White Sox win, so why spend money?'" Selig disagrees and maintains that black baseball fans can be won back.

MLB has tried to woo African Ameri-

their first experience owning a mitt or taking batting practice. When director Darrell Miller, a former major leaguer, took groups of students to see Dodgers and Angels games, that was a first, too.

Less impressive is baseball's marketing to Black America. "It doesn't make sense to me why they wouldn't do more," says Richard Lapchick, head of the DeVos Sport Business Management Program at the University of Central Florida. Solomon, MLB's highest-ranking black official, agrees: He's pushing for more daring marketing of the sport's top black stars, such as Florida Marlins pitching sensation Dontrelle Willis and Philadelphia Phillies slugger Ryan Howard. Says Solomon: "We've got to take these names



**Black players held just 9% of roster spots in 2005. That's down from 18% in 1991**

cans. Ten years ago, Selig presided over a season-long tribute to Jackie Robinson on the 50th anniversary of baseball's first black major leaguer. (Another league-wide tip of the cap is planned for next season, the 60th anniversary of Robinson's debut.) Events honoring Negro League history are now common. And MLB's most ambitious outreach to inner-city blacks is the Urban Youth Academy in Compton, Calif., a 10-acre oasis where young boys and girls play on manicured fields and are schooled in the game—on MLB's tab. This year, in the academy's inaugural summer, about 900 boys and girls enrolled, most of them from troubled neighborhoods, almost all of them black. For many, it was

and make them cool."

But Tim Brosnan, MLB's executive vice-president for business, endorses the league's efforts and says: "There aren't any plans to market players differently than we have. That includes Latino players, African American players, players of all colors and stripes."

It may well be that MLB, setting attendance records year after year, figures if it ain't broke, why fix it? But it pains owners such as Reinsdorf to watch the African American audience slip away. "It's not an immediate problem," he grants. "But if we're America's game, we want all of America to be interested." ■

#### AN ERA PAST?

Jackie Robinson plays at Ebbets Field in 1952



# Finding Nirvana In a Music Catalog

A growing hunger for songs on TV and in films is driving up revenues for music publishers

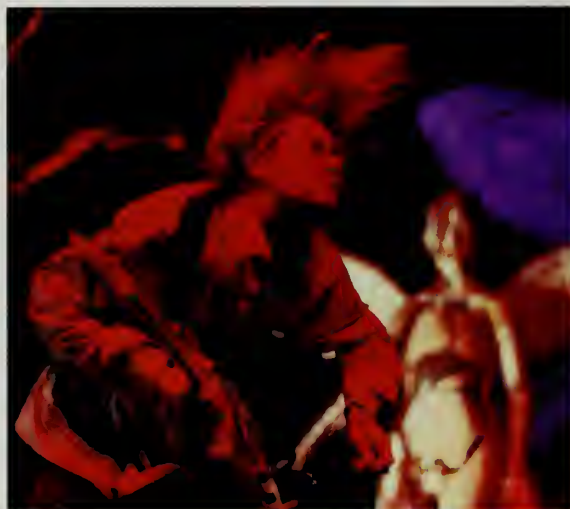
BY TOM LOWRY

**I**N THE 12 YEARS SINCE KURT Cobain entered rock's pantheon after taking his own life, the mournful singer's music has been untouchable. His songs with the band Nirvana have been fiercely guarded, seemingly too important to be exploited for a buck. But now a few Cobain-penned songs will play feature roles in an episode of the hit show *CSI: Miami* during the November TV sweeps as part of a new, aggressive promotion of Nirvana's catalog. So rare is the use of Nirvana's music in this way that the writers of the CBS show, one of the most widely syndicated in the world, are scripting the storyline around the themes of Cobain's lyrics. "This is a very cool thing, and very unusual in TV," says P.J. Bloom, the music supervisor for *CSI: Miami*, who is in the process of choosing among the Cobain repertoire.

## A "SLEEPY BUSINESS" NO MORE

THAT THE NIRVANA library, tightly controlled for years by Cobain's widow, Courtney Love, is suddenly available for commercial use reflects a new frontier in the music business. A largely overshadowed stratum of the industry, companies owning music catalogs, from the big outfits like EMI (with 1 million-plus songs) to hedge fund-backed independents, is suddenly growing in influence as movies, TV, commercials, and even Internet offerings grow hungrier for sound.

Music publishing has always been a reliable, if prosaic, end of the business, controlling the rights that guarantee a stream of royalties paid to publishers and songwriters every time



songs—in tasteful ways, of course," he says. A huge cadre of fans who saw Cobain as a spokesman for their generation wince at the idea that Nirvana's music could end up helping to sell hamburgers or body spray (marketers must be quivering at the chance to use Nirvana's music, like *Teen Spirit*). "It's going to get a uglier," says Lyle Hysen, who runs New York music-licensing outfit Bank Rob Music, which focuses on indie artists. "I mean, even though Kurt was signed to a major label, this goes against every grain of whatever integrity the guy had. It's just you're gonna cry." Fees for using Nirvana songs in *CSI: Miami* are still being negotiated, but some executives say it could

\$50,000 a song, depending on which ones are selected.

These days, music supervisors like Bloom, who pick songs to make scenes, are Hollywood's new power players. Crumb, who reviewed the pilot of FX's *Nip/Tuck* series, about two plastic surgeons, notes the eerie use of The Rolling Stones' *Paint It Black* to dramatize a facial reconstruction even before mentioning the plot or the performance.

**COBAIN** Songs from the late Nirvana singer will turn up on *CSI: Miami*

a tune is sold in a record store or aired on the radio. The glitz was always with the artists and the labels. But in today's booming market for so-called synchronized music—tunes matched up with visuals on TV and movies—publishers are freely negotiating their fees, no longer relying on predetermined payouts under copyright laws (9.1¢ per song) and those set by collection organizations like the American Society of Composers, Authors and Publishers. "[Publishing] used to be kind of a sleepy business," says Larry

es. Replacing bland scoring, hot plays from shows like *Grey's Anatomy*, *Wipeout*, and *Rescue Me* are big sellers on iTunes, giving soundtracks new clout to draw audiences to TV.

Besides the payoff, Love sees opening up Nirvana's catalog as a way to introduce a new generation to her late husband's music, says her manager, Peter Asher. "In my view, if 10 kids hear the song and ask 'Hey, who was that?' then we've maintained Nirvana," he says. Primary Wave's Mestel, whose company is backed by hedge fund Plainfield Asset Management and a Wall Street bank he declined to name, says all kinds of offers have poured in to use Nirvana's music. "We have turned down dozens of opportunities," including a beer commercial and movie *X-Men: The Last Stand*. Still, says Cobain loyalists tuning in to the *CSI: Miami* episode will no doubt accuse Mestel of selling out their hero. His latest deal, Sept. 15 promises to be far less controversial: buying a stake in the catalog of 1960s pop icons Hall & Oates. ■

—With Jon

## THE STAT

**\$4.25**  
BILLION

Global revenues from music publishing in 2005 (up 8%, vs. 2004)

Data: Informa

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It turns out there are lots of little brothers and sisters who have watched in wonder as their older siblings labor over signing their Web pages. "Hot new things for teenagers always trickle down to younger and younger audiences," Robin Raskin, a consultant in new me-

## TRAINING WHEELS

ACTUALLY, SOCIAL NETWORKING is gratifying to the whole family. Not only are there sites for college and high school students and preteens, but new networks aimed at keeping families connected are popping up, too. Niche networks that reflect lifestyle interests, from golfing to gardening, are also gaining momentum.

Parents are paying more heed to kiddie sites because they know their children will learn, work, and live online. Computer skills such as social networking are becoming as much a part of the successful life portfolio as addition and subtraction, says Herbert S. Lin, senior scientist at the National Research Council. Parents' support of these sites stems in part from the idea that it's better for their kids to get online introductions in a controlled environment—as many of these sites promise—than venture into the cyberjungle alone. "They provide Internet safety on training wheels," says Raskin.

Indeed, most of these MySpace-like pre-tweeners sites have stiff parental controls, safety features, and advertising-free palettes. Several have word filters, employees who monitor the discussions in real time, and the requirement that parents provide their credit card and e-mail address to ensure adult approval.

Even so, pre-tweeners' social networking has its critics. "There are no assurances

who your child is going to," says I. Magid, co-founder of BlogSafety.com. While the sites offer more interactivity and educational potential than video games, TV, a screen's size and many parents agree the time used should be limited.

Still, I figure interactive skills. Club Penguin is giving parents a more preferable alternative. Lately, after school, Lee tells me he has run off to log on to Club Penguin. His friends are waiting for him. ■

# MySpace for The Sandlot Set

Social networks like Club Penguin are quickly catching pre-tweens' attention

BY TODDI GUTNER

**I** BOUGHT A FLAT-SCREEN TV and a stereo system!" shouts my nine-year-old son, Lee, as he shakes me awake one morning. For a kid who typically needs to be dragged out of bed, this is curious behavior. I'm worried. Did Lee get hold of my credit card and go on some QVC binge? "Nooooo, Mom," he says. He quickly explains that the TV and the stereo are virtual. Since that morning in July, Lee often has been waking up early to partake of his new obsession: social networking among the sandlot set.

Lee is big into his membership in Club Penguin, one of the new sites aiming to be the MySpace.com for 8- to 12-year-olds. Officially launched in March, it clocked in 2.1 million unique visitors during the month of August, up from 899,000 in March, according to comScore Networks Inc.'s Media Metrix. It joined sites imbee and Tweenland.com, where kids can craft personal pages with videos, photos, and blogs. Some of these sites also offer educational games for kids, joining a growing online community of sites that give parents a

break and kids a chance to learn (table). "Addressing young kids is very difficult because of privacy laws, but it seems these companies have figured out a model that works," says David Card, vice-president and senior analyst at JupiterResearch.

## Can Johnny Log In and Play?

These sites target the 8-to-12 crowd, offering a variety of safety features:

| SITE                            | SAFETY FEATURES                                                                                                           |
|---------------------------------|---------------------------------------------------------------------------------------------------------------------------|
| <a href="#">clubpenguin.com</a> | Parent's e-mail address required, scripted conversations, word filters, and online monitors                               |
| <a href="#">imbee.com</a>       | Parent approval required, parental monitoring of content, no interactivity with other members without parent's permission |
| <a href="#">neopets.com</a>     | Parent's e-mail address required; online monitoring                                                                       |
| <a href="#">whyville.net</a>    | Parents must fax permission for chatting rights, users must pass safety test to chat                                      |
| <a href="#">toontown.com</a>    | Parent's permission required for interaction with others, online monitoring                                               |
| <a href="#">Tweenland.com</a>   | Online monitoring of some words and content                                                                               |

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# The Emblems Of War

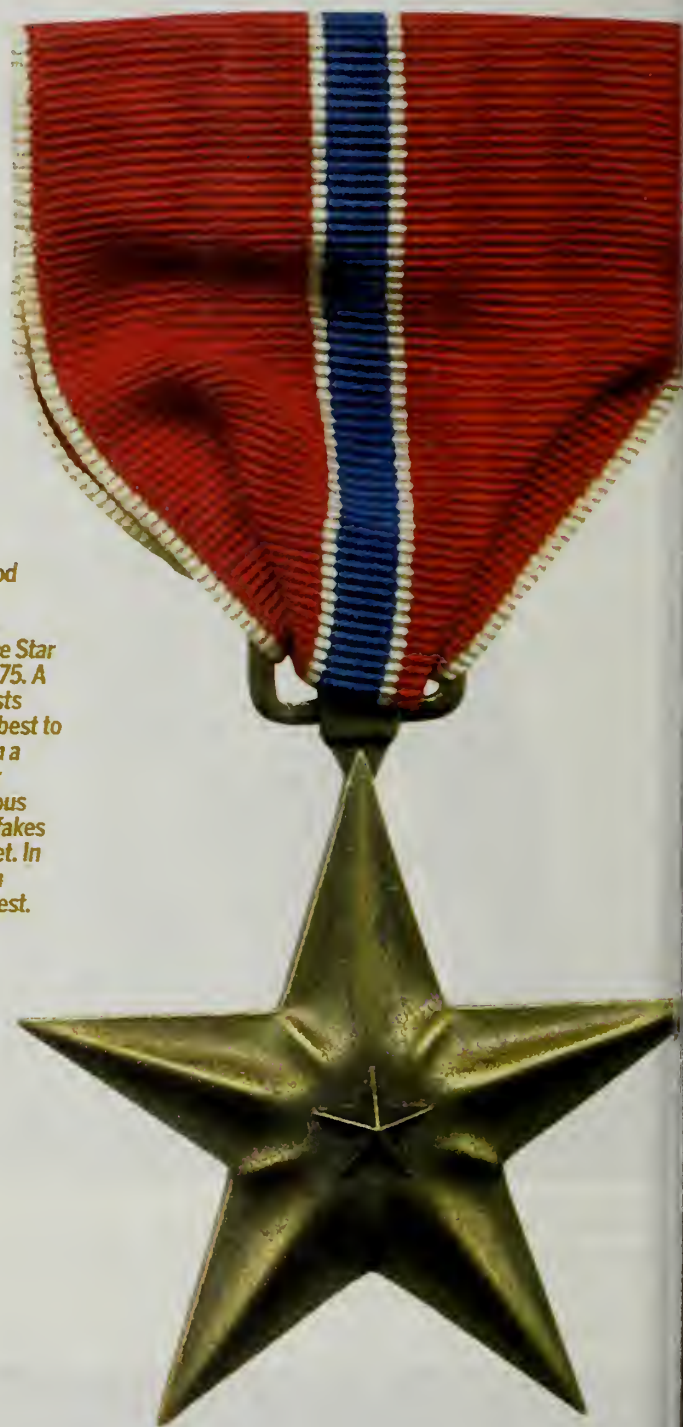
Two new World War II films could fire up the market for memorabilia, from souvenirs to Sherman tanks.

**BY THANE PETERSON**

**T**HE LAST TIME collectors really got jazzed about Grandpa's dusty old medals, helmets, and bomber jackets from

World War II was a dozen years ago, around the 50th anniversary of D-Day. Some got so caught up in the excitement, they even bought Sherman tanks and vintage planes. ¶ Now, two new films seem likely to stir up World War II fever again. *Flag of Our Fathers*, Clint Eastwood's epic on the bloody battle of Iwo Jima, is set for release in October, while a seven-part Ken Burns documentary is scheduled to air on public TV in fall of 2007. If the response is anything like it was to his 1990 Civil War documentary, Burns says, the memorabilia market will reignite. ¶ So this is an excellent time to bone up on the

*Medals are a good focus for new collectors. This American Bronze Star goes for about \$75. A Purple Heart costs around \$35. It's best to buy medals from a reputable dealer because numerous highly accurate fakes are on the market. In general, German medals are priciest.*



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A WW II-era Corsair fighter like this Navy FG-1D owned by collector Jerry Yagen ([fighterfactory.net](http://fighterfactory.net)) recently sold for \$2.5 million.



Parts and gear from ships, tanks, and planes are popular collectibles. Dealer Bill Shea has priced this clock from the deck of a U.S. Navy vessel at \$495.

material and pick up some items before the competition heats up. Boston books dealer and collector Ken Renwick, whose by-appointment-only museum is outside Boston houses perhaps the world's most important private World War II collection ([museumofworldwar2.com](http://museumofworldwar2.com)), suggests studying the logs and Web sites of dealers such as Larry Petersen in Petaluma, Calif. ([militaryantiquesmuseum.com](http://militaryantiquesmuseum.com)), H. Otoupalik in Missoula, Mont. (406-481-7), and Bill Shea in Hubbard, Mass. ([therupturedduck.com](http://therupturedduck.com)). The don-based Bonhams & Butterfields auction house ([bonhams.com](http://bonhams.com)) holds regular military sales, and Kansas City's Man-

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 Start

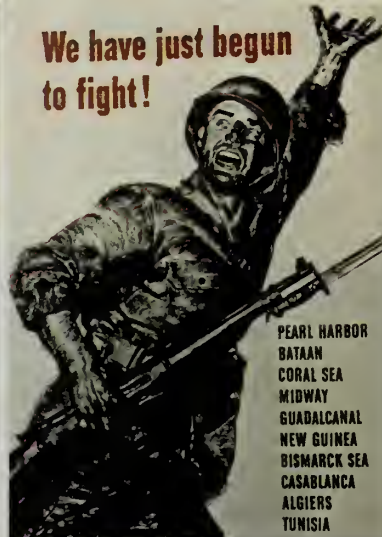
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Large posters in mint condition go for \$200 or more, such as these two from Ken Rendell's collection, aimed at pumping up public enthusiasm for the expected U.S. invasion of Japan late in the war. Ditto for mint posters from wartime Britain, Germany, and occupied France. Wartime posters in mint condition by Norman Rockwell fetch a lot more.



We have just begun to fight!



Collectible guns (and the armaments on tanks and warplanes) must be disarmed according to strict federal rules. Dealer Wally Petersen has priced this deactivated American M-1 carbine at \$600.

tions.com) is a source for inexpensive items. Once you've found a focus, check out speciality sites such as gerlaggers.com and books on medals, uniforms, and the like by publishers such as Schiffer Publications (jffpub.mb.ca/fer\_publications.htm).

## "HOME FRONT" ITEMS

IF YOU CAN BUILD a collection on any budget, at the high end are collectors such as Paul Allen (paulallenheritage.com), and mining heir Jacques Littlefield (jacqueslittlefield.com), who keeps 225 tanks and other military vehicles on his 470-acre ranch near Palo Alto, Calif. At the other end, posters, postcards, and magazines can be had for a few dollars. Bayonets, helmets, and tunics start at \$10 and rise into the thousands.

If your interest is aviation, Gerald Yarnall, CEO of the Aviation Institute of Maintenance, a chain of aircraft-maintenance training centers, suggests seeking out the compasses used in warplanes. Yarnall notes that World War II-era toys, tools, and other "home front" items are widely available for under \$100. Other items for a novice, he says, are pens and markers stamped with the words "Remember Pearl Harbor." Adds Harry W. Jr., an Army sergeant in Redding, Calif., who co-authored a 1993 book about

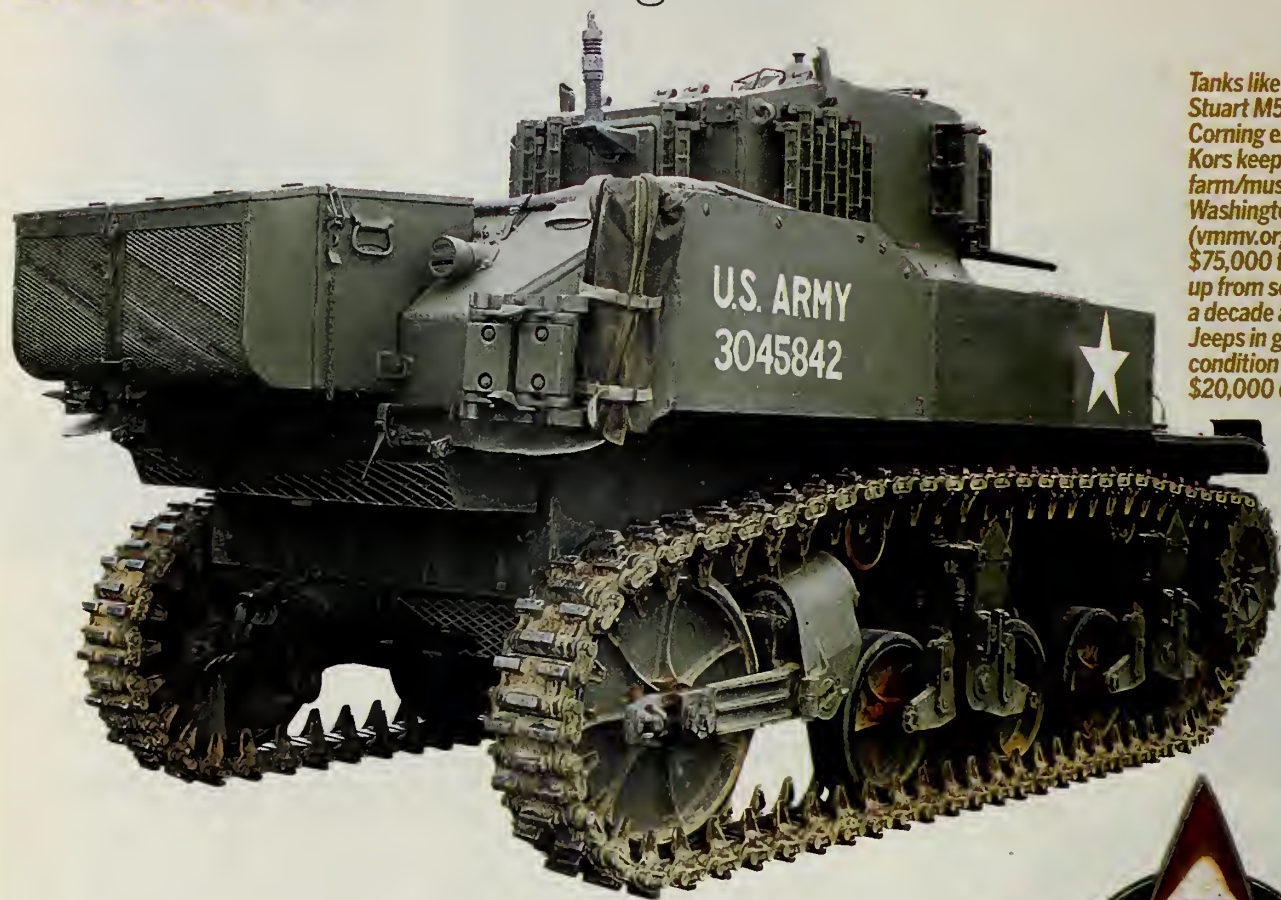
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Tanks like this rare Stuart M5 that re-creating exec Allan Kors keeps on his farm/museum in Washington, D.C. ([vmmv.org](http://vmmv.org)) go for \$75,000 to \$100,000 up from some \$30,000 a decade ago. Rare Jeeps in good condition run from \$20,000 on up.



The Order of the Red Star is the Soviet equivalent of the U.S. Bronze Star and is prized for its fine workmanship.

World War II collectibles: "I always start with family. You may have a grandfather or uncle who has something to give you if you ask."

## SIDEWALK FIND

IT ISN'T LIKE the old days, 40 or so years ago, when Rendell nabbed rare World War II mementos, such as grappling hooks to scale the cliffs during the invasion of France or a French flea market. But treasures will continue to surface as veterans and their heirs clear out attics. Last summer, Larry Kelley, a semi-retired entrepreneur from Mardela Springs, Md., nabbed a German warplane gyroscope for \$5 and a German dress bayonet for \$10 at a walk sale in Florida. The items' re-

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or maybe  
send one  
to the editor.







Rendell paid \$5,000 for the letters and photos of this Japanese-American couple. Their story is poignant because the wife received news that her husband had been wounded in battle while she was in an internment camp.

Hand-painted leather jackets worn by American aviators that sold for \$75 two decades ago now start at \$1,000 and go for more if the collector can document the owner's story—as Rendell can with this one, known as Double Trouble.



American GI helmets in good condition sell for about \$250. Rarer paratrooper helmets (this German one) can top \$10,000.

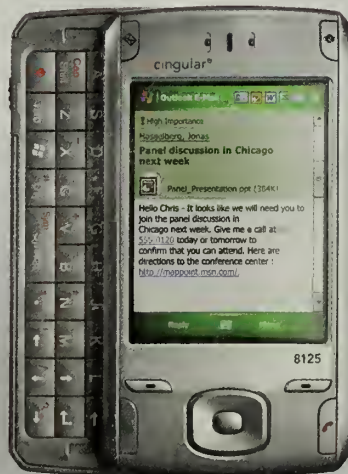
the figures: \$500 and \$150. Caveat for, however. Fakes are rife on eBay, especially medals and uniforms. Unscrupulous sellers also put together seemingly intact uniforms or medal assemblies from several sources, so get a certificate of authenticity.

While there are kooks out there who revere Nazi material, most collectors are interested in honoring the sacrifice of those who fought in the war. Burns notes that many of the vets are in their 80s, and many are dying at a rate of about 1,000 a day. It was the greatest cataclysm in world history, he says. "There's something extremely powerful about holding the things [the men and women] held." ■

**BusinessWeek online** For a slide show of World War II collectibles, go to [businessweek.com/extras](http://businessweek.com/extras). For more on collectors of war artifacts, watch BusinessWeek Weekend or see video clips at [businessweekweekend.com](http://businessweekweekend.com)



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# You'll Always Have Paris, If Only for the Afternoon

Your meetings are over, and it's time to see a bit of the City of Light. Here are five things to do that aren't clichés. **BY CAROL MATLACK**

**1 Stroll the Canal St. Martin.** » Built in the 1820s to carry barge traffic between the Seine and outlying stockyards, the canal today is a tree-shaded oasis with pedestrian bridges and benches. Although the area is gentrifying, it retains the flavor of what Parisians call a *quartier populaire*, or people's neighborhood, where trendy boutiques abut auto-parts stores.



**2 Study Haute Cuisine.** » Leading culinary schools offer short courses in preparing foie gras or whipping up a sauce béarnaise. The venerable Cordon Bleu on the Left Bank, the Ecole Lenôtre on the Champs-Élysées, and the Ecole Ritz Escoffier at the Place Vendôme offer half- and full-day classes in English. Most sessions cost less than \$200.

**3 See Versailles Without Mirrors.** Directly across the street from the famous palace is La Grande Écurie, the old royal stables. The beautifully restored 17th century facility now houses an equestrian school run by the trainer known simply as Bartabas. Seated on risers in an arena with crystal chandeliers and baroque music playing, visitors on most weekend mornings can watch a 45-minute dressage session, where trainers guide their horses through exquisitely precise movements (\$10.) Afterward they can visit the stables. Weekend afternoons and nights feature musical shows for \$20 to \$25, including

a remarkable, dreamlike sequence in which riderless horses slowly gather together and gallop rhythmically around the arena.

**4 Visit a Small Museum.** The Fondation Cartier is a contemporary art museum founded in the 1980s with backing from the well-known jewelry house. Located in the 14th Arrondissement, the glass-cube structure by architect Jean Nouvel is worth looking at in itself. So are the unusual exhibits, such as a show opening this fall by U.S. video artist Gary Hill.

**5 Go Shopping.** » The specialty retail districts of Paris remain untouched by the force of globalization that has put Gap and Starbucks stores all around the world. From the music shops along the rue de Romme to the stationery stores on rue du Pont Louis-Philippe, like merchants cluster together, creating an intense shopping experience. Also check out the arcades threading their way through the 2nd, 9th and 10th Arrondissements. Each has a distinctive ambience, ranging from the upscale Galeries Vivienne behind the Palais Royale, to shabbier cousins such as the Passage des Panoramas, which specializes in rare stamps and vintage postcards. For more on Paris sites and restaurants, go to [businessweek.com/paris](http://businessweek.com/paris).



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BY ROBERT PARKER

# Delicious Reds at Down Under Prices

The shiraz grape, known as syrah in France and California, makes for some of Australia's best red wines (Parker on Wine, Aug. 21). But the Aussies also do a great job with cabernet sauvignon, grenache, merlot, and other reds, both as varietals and in shiraz blends.

## Cheeky Chick 2004 Peeper's Blend

**87 points.** Seventy percent shiraz and 30% cabernet sauvignon (with dollops of mourvèdre and viognier), this wine exhibits a dark ruby color as well as a peppery, herb, white chocolate, and black cherry-scented bouquet, velvety tannin, and a supple texture. It will provide delicious drinking over the next one to two years. \$10

## Bleasdale Vineyards 2003 Shiraz/Cabernet

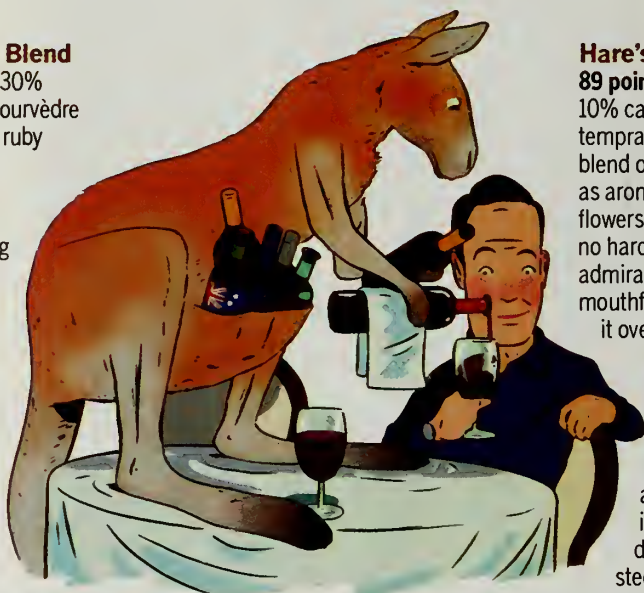
**89 points.** Aged in American and French oak hogsheads (300-liter barrels), the shiraz/cabernet blend (51% and 49%, respectively) possesses an opaque ruby/purple color as well as a big, sweet nose of herb-tinged black currant fruit, high-class cigar smoke, dried herbs, weedy sweet currants, and spice. Its layered mouthfeel and silky texture suggest it can be drunk now and over the next three to four years. \$14

## Marquis Philips 2004 Cabernet Sauvignon

**90 points.** This classic cabernet sauvignon offers telltale aromas and flavors of black currants, high-class cigar smoke, and herbs. Medium to full bodied with dense, layered fruit flavors, admirable depth, an attractive suppleness, and an easygoing style, it should drink well for two to three years. \$15

## McLean's Farm 2004 Shiraz/Cabernet

**90 points.** Wow, what a superb bargain this equal part blend of shiraz and cabernet



sauvignon represents. It's a dark ruby/purple-colored wine with a sweet nose of fine cigar smoke intermixed with dried herb, cassis, and cherry characteristics. This deep, fleshy, medium-bodied blend possesses delicious ripe fruit, good underlying acidity, and notions of plums, allspice, and loamy soil in the finish. Drink it over the next three to four years. \$15

## Kilikanoon 2003 Cabernet Sauvignon Killerman's Run

**90 points.** Comparable to most \$40-\$50 California cabs, this wine has a deep ruby/purple color, plenty of earth, herb, and black currant traits, a medium to full body, and fine flesh as well as length. This is a tasty red to drink over the next four to five years. \$17

## Hare's Chase 2004 Red Blend

**89 points.** With 70% shiraz, 16% merlot, 10% cabernet franc, and tiny amounts of tempranillo and cabernet sauvignon, this blend offers a dark ruby/purple color as well as aromas of cherries, black currants, and flowers. It has a graceful entry on the palate with no hard edges, lush fruit, surprising elegant admirability, freshness and purity, a layered mouthfeel, and medium-bodied flavors. Drink it over the next two to four years. \$17

## Tait 2004 The Ball Buster Proprietary Red

**93 points.** A classic Barossa Valley effort in terms of bigness, boldness, and a dramatic display of fruit and intensity. If you want something delicate, restrained, and understated, steer clear of this locomotive that crashes over the palate with a flamboyant display of blackberry and cassis fruit, licorice, tar, and spicy oak. Explosively rich with formidable intensity, this blend of 70% shiraz, 15% cabernet sauvignon, and 15% merlot is an amazing wine for the price. Be forewarned that this wine possesses 15.6% alcohol, but carries it well. \$18

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## Before You Leave the Beaten Path...

Brokers can tell compelling stories about quirky ways to diversify, but take a good look at the details before you leap. **BY AARON PRESSMAN**

**S**ure, it's risky, so you should only invest 5% of your assets." How many times have you heard that caveat tacked on to a sales pitch from a broker or adviser trying to get you to invest in some quirky venture? If you're not careful with those 5% or 10% bets, you can quickly end up with 25% or more of your portfolio sitting far out of the mainstream, in what are often illiquid investments. If, those targeted bets could make sense if you tend to have near- of your liquid net worth tied up in U.S. stocks and bonds. The enge is to find investments that make economic sense—and, commissions and fees, give you a reasonable shot at making ey. To gain the benefits of diversification, whatever you choose ld have little or no correlation with the stock market. "There's a e panoply of markets available to us," says Robert Arnott, chair- of Research Affiliates, an investment management firm in dena, Calif. "We should all broaden our investment horizons."

### Timber

**THE PITCH:** Forest properties give you a double play: current income from logging sales and capital appreciation from the rising value of growing trees. Over the past 25 years, timber gained an average of 12% a year with less volatility than the Standard & Poor's 500-stock index, according to the Hancock Timber Resource Group. Better yet, the returns had a negative correlation with stocks, bonds, and even commercial real estate. Adding a 10% timber allocation to a typical stock and





bond portfolio could raise returns by 0.4% a year while reducing volatility by 1%, Hancock says.

**THE REALITY:** The bulk of returns in timber comes after years of tree growth, so it isn't an investment for short-timers or those who may need to cash out in a hurry. The homebuilding boom pushed timber prices to record levels, but the bust hasn't reduced values much. Waiting a year or two may provide a better buying opportunity. Investing used to be limited to large pension funds and ultra-wealthy families, but a growing class of timber investment management organizations, or TIMOs, has reduced the required minimum to several hundred thousand dollars. Expect to pay management fees of up to 2% a year plus a small slice of the gains in years the fund does well.

## Rare Coins

**THE PITCH:** With two well-respected rating agencies to ensure numismatic authenticity, it's now possible to create a coin investment portfolio. Over the past 60 years, rare coins returned an average of 10% a year with volatility on par with corporate bonds and

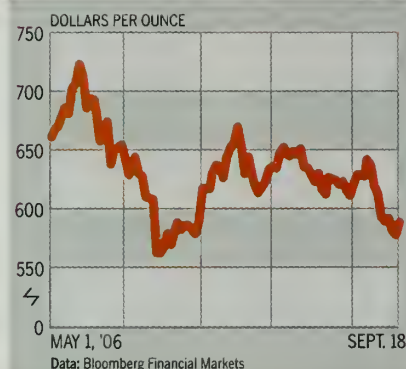
lower than stocks, according to research by Robert Brown, chief investment officer at Genworth Financial Asset Management. Coin prices typically move in the opposite direction from bonds and have little connection to stock prices. "The market has the depth and quality needed" by financial investors, says Brown, who estimates the market to be about \$40 billion. And, he adds, growing interest in collecting is driving up prices, a trend that will only accelerate in coming years.

**THE REALITY:** Coins are bought and sold on a negotiated basis, so expect to pay for expert advice, and don't try to sell in a hurry. Collections need to be kept in a secure location to prevent theft and damage from excess humidity. One big knock: Collectibles aren't eligible for the 15% capital-gains tax rate. They do, however, qualify for a 28% capital-gains tax rate.

## Gold

**THE PITCH:** Perhaps the oldest asset class of all, gold has typically been seen as a

## GOLD'S RECENT SELL-OFF



hedge against currency devaluation, global turmoil, and inflation. More recently, the metal has been in heavy demand in the growing markets of India and China. That pushed gold prices to over \$700 an ounce earlier this year, from about \$400 at the beginning of 2005. Of late, it has traded below \$600, sparking renewed interest. An annual market assessment issued on Sept. 12 by GFMS, the influential London metals research firm, predicted that central banks will sell less gold and few new mines will come online over the next year, pushing prices back over \$700 in 2007.

**THE REALITY:** Gold can get stuck in the doldrums for years at a time. People who bought gold at \$800 in 1980 are still waiting to break even. An investor in gold has to "be prepared to endure these kind of mediocre returns over long periods of time in order to enjoy the diversification benefits," says San Francisco financial adviser Milo Benningfield. Gold has shown a strong correlation with the U.S. stock market over the past year, but the link unravels when viewed over prior decades.

## International Real Estate

**THE PITCH:** International real estate portfolios have outperformed both U.S. stocks and U.S. real estate for years at a time over the past few decades, according to academic research. A portfolio including U.S. and foreign real estate had returns four percentage points higher per year than stocks alone, with the

same degree of volatility, according to a study in the *Journal of Real Estate Portfolio Management*. "Adding a small amount can have a huge impact on a portfolio," says Veena Kutler, investment director at Mosaic Wealth Management in Bethesda, Md.

**THE REALITY:** Assembling a portfolio of properties takes more resources—travel time—than most investors spare. Morgan Stanley, AIG Global Investment Group and others offer private international real estate investment funds to high-net-worth individuals. In the past, the funds have reported phenomenal results, but investors typically can't withdraw their money for years.

## Oil

**THE PITCH:** If you were the one selling maybe you wouldn't bristle at \$3-a-gallon gasoline. Even though oil is down nearly 20% from the August 1 price of \$77 a barrel, the world is not going to shed its dependency for decades, if at all. The recent short-term drop came as hedge funds and other speculators liquidated more than half of their bets in oil futures markets in just four weeks. It has left the market poised for an uptick, according to analysts at Barclays Capital. You should also own oil as a diversification hedge—it tends to gain when the grain market backslumps.

**THE REALITY:** Investors have long been able to buy into energy partnerships, but the deals have been subject to mismanagement and other risks that have little to do with the price of oil. They also have high fees and little liquidity. That's why the United States Oil Fund, an exchange-traded fund that's a pure play on crude, an intriguing option. Its history is short, but since the fund launched in April it has largely moved in the opposite direction from stocks.

Although oil is subject to sizable price swings, over the long term the price is closely related with economic growth. In a global slowdown, oil prices plummet and investors have a close correlation with sagging stocks at that time.

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# Those Options Could Cost You

The backdating mess could hit innocent employees with big taxes and penalties. **BY ANNE TERGESEN**



exercised their shares, says S. Ja DiBernardo, a partner at Morgan, Lu & Bockius in Palo Alto, Calif. Those owners who sold their shares before qualifying for the capital-gains tax have already paid regular income tax. Backdating can allow an exemption ISOs enjoy from Social Security and Medicare taxes.

Backdated options that vest after 31, 2004, are another source of tax trouble. Options issued below the stock price on the grant date are subject to a new provision of the tax code, known as 409 A, which kicks in when the options vest, rather than when they're exercised. Holders of vested, backdated options owe not only regular income tax but also a 20% penalty and possibly interest as well.

The Internal Revenue Service has yet to issue final regulations specifying how it will apply the penalty. Lawyers say the agency is unlikely to impose penalties on backdated options that were exercised before 2005. And it will allow employees to avoid problems if they take certain steps by the end of 2006—a deadline lawyers believe will be extended. One solution is for employees to identify, in writing, a specific year in which they will exercise the affected options, says DiBernardo. If you promise to exercise in, say, 2007, but fail to do so, the options are forfeited.

Companies can also help employees avoid 409 A consequences. Brocade, a data storage company with a working concern, offers to exchange backdated options for cash or new options plus cash. DiBernardo says he is working on similar arrangements that would reprice options and other outfits. Such arrangements may be the best that innocent employees of tainted options have hope for. ■

**T**HE EXECUTIVES RESPONSIBLE for backdating employee stock options are in big trouble, facing everything from shareholder lawsuits and tax audits to possible jail time.

But now innocent employees who received certain kinds of options may get caught in the snare, too. They could owe unanticipated tax as well as interest and penalties.

It's not clear how many grants were backdated, or how many people have been swept into the mess. Still, some companies that have admitted to backdating, such as Brocade Communications, Comverse Technology, Mercury Interactive Corp., and Broadcom, say they distributed tainted options to many levels of employees. Research firm Glass, Lewis & Co. says 138 businesses—and counting—are under internal or government investigation. "Quite a large number of people could be affected," says Michael Sirkin, head of the executive compensation practice at the Proskauer Rose law firm in New York.

Backdating creates potential tax problems for two groups: those with incentive stock options (ISOs) and those with any

option—ISO or nonqualified—that vests after Dec. 31, 2004. ISOs are the more desirable perk. If holders exercise them and keep their shares at least a year, the profits are generally taxed at the 15% capital-gains rate. Better still, the tax is not due until the stock is sold. With nonqualified options, regular income tax of up to 35% is due when the option is exercised.

When backdated, ISOs generally are treated as nonqualified options. That's because the tax laws say ISOs must be issued at or above the stock's price on the grant date. Backdating happens when a company assigns a grant a bogus issue date, on which the stock sold at a lower price. That enhances option holders' opportunity for profit.

## NO EXEMPTION

THOSE WHO HAVE already exercised backdated ISOs may have to amend their tax returns. Aside from owing income tax—rather than capital-gains tax—on their profits, they may also be hit with interest for failing to pay tax when they

**Holders of backdated options may owe a 20% penalty, plus interest**



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BY GENE G. MARCIAL

**A DRUG RIVAL MAY BE EAGER TO SWALLOW SCHERING-PLOUGH.**

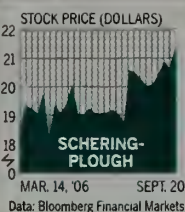
**NEWELL RUBBERMAID IS STARTING TO SPARKLE AND SHINE.**

**THE CLEVELAND CLINIC TEAMS UP WITH CLEVELAND BIOLABS.**

## Shopping for Schering?

**T**HE BUZZ ABOUT SCHERING-PLOUGH (SGP) on Wall Street is that the company is in play. It may do a merger deal with Bristol-Myers Squibb. Or it could be acquired by either Merck or Johnson & Johnson. Speculation swirled after Schering agreed to pay \$435 million to settle criminal and civil charges of alleged fraudulent marketing and pricing practices—without admitting any wrongdoing. It's the last of the big cases from the former management that CEO Fred Hassan, who took over in 2003, had to deal with. Shares inched up from 19 on Aug. 24 to 21.45 on Sept. 20. Rumors about Bristol-Myers' future moves arose after CEO Peter Dolan left the company on Sept. 12. The stock climbed from 19 in August to 24 on Sept. 20. A merger of equals "has merit" and could work, says Catherine Arnold of Credit Suisse, which has done banking for both companies. Schering is a buy on its fundamentals, she says; a merger would be a bonus. Arnold says Bristol-Myers might be willing to pay a 30% premium, or 27 a share, for Schering. Barbara Ryan of Deutsche Bank sees "strong strategic merit" in a merger with Bristol-Myers, which says it is "well positioned for growth" as an independent. Pros say that Schering might become a target because it has a joint venture with Merck for anticholesterol drugs Zetia and Vytorin, whose combined 2006 sales are expected to hit \$3 billion. Also, it has marketing rights to J&J's autoimmune drug Remicade/CNTO-148 outside the U.S., except Japan. Schering and J&J said they don't comment on speculation. Merck did not return calls.

### THE PRICE IS INCHING UP



## Cleaning Up At Newell Rubbermaid

**A**FTER SEVERAL YEARS of disappointing results, Newell Rubbermaid (NWL) is finally winning the Street's favor. A maker of kitchenware and toys, Newell is "regaining investor confidence as it turns around and gets back to providing consistent returns," says Lee Schultheis, investment chief at Alpha Hedged Strategies Fund, which owns stock. Newell has beaten analysts' forecasts in the past two quarters, he notes, and the stock jumped from 24 in July to 28.29 on Sept. 20. Schultheis expects it to hit 34 in a year,

or 17 times his 2007 profit forecast of \$2 a share. This year he expects Newell to earn \$1.80, up from \$1.60 in 2005. Strong results in the first half indicate a turnaround that "should continue in the second half," says Dara Mohsenian of JPMorgan Securities, who rates it "overweight." Increased spending on R&D, advertising and new products aided the turnaround, he adds.

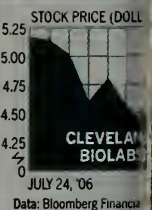
### A LEAP AT LAST



## A Shot in the Arm For Cleveland BioLabs

**C**LEVELAND CLINIC FOUNDATION, famous for treating heart ailments and cancer, has joined forces with Cleveland BioLabs (CBLI), which received exclusive rights to its cancer and molecular genetic technology. Since BioLabs has used the Clinic's technology to produce two drugs: Curaxins, now in Phase 3 trials, aimed at prostate and renal cancer; and Protectan, used to treat exposure to levels of radiation, both nuclear and radiographic. Cynthia Ekberg Tsai, general partner at Madelin Fund, which invests in cancer-related stocks, says BioLabs is a "timely buy," because for the first time the Cleveland Clinic can commercialize "its advanced and innovative technology for cancer and tissue protection—through Bio-Labs." It went public on July 21 at 6 and is now at 4.80. The Clinic will provide \$5 million a year in research and infrastructure, says BioLabs CEO Michael Fonstein. BioLabs has received grants of \$9 million from the National Institutes of Health, Defense Dept., and NASA. And it expects \$4 million more from various sources, mainly Defense, which is interested in Protectan. Stewart Flink of Crestview Capital, which owns shares, says Curaxins has killed human cancer cells transplanted into other primates. It is BioLabs' most promising new drug, says Flink. ■

### DOWN A BIT FROM ITS IPO



**BusinessWeek online**

Gene Marcial's Inside Wall Street is posted at [businessweek.com/investor](http://businessweek.com/investor) at 5 p.m. EST on the magazine's publication day, usually Thursdays.

**Note:** Unless otherwise noted, neither the sources cited in Inside Wall Street nor the authors hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.





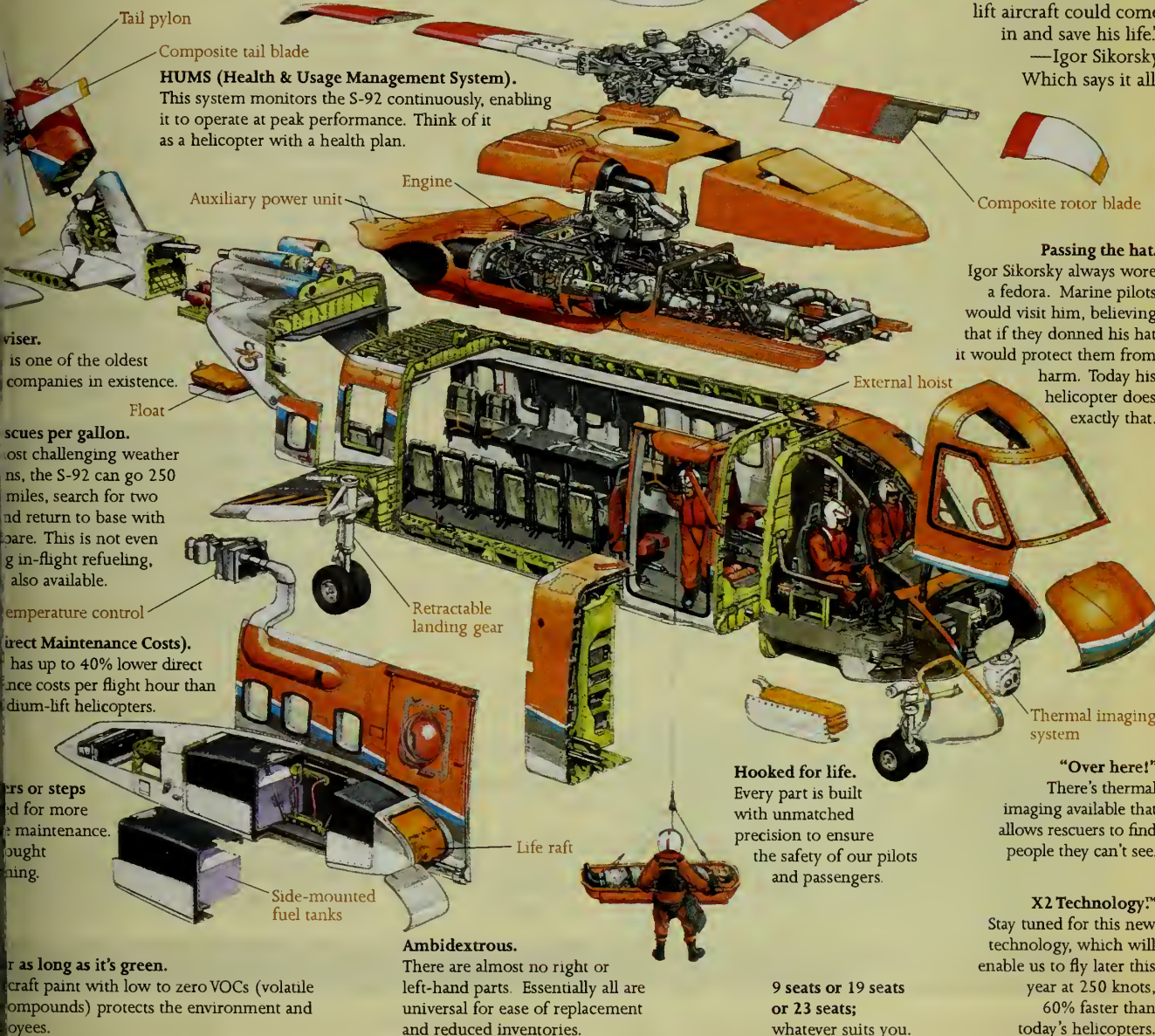
### Here comes hope.

The first civilian helicopter rescue took place in 1945 off the coast of Connecticut.

$$FM = \frac{C_{T1}^2}{\sqrt{2} C_Q} \quad (\text{Hover efficiency ratio})$$

"If a man is in need of rescue, an airplane can come in and throw flowers on him and that's about all. But a direct-lift aircraft could come in and save his life."

—Igor Sikorsky  
Which says it all.



### HUMS (Health & Usage Management System).

This system monitors the S-92 continuously, enabling it to operate at peak performance. Think of it as a helicopter with a health plan.

### Passing the hat.

Igor Sikorsky always wore a fedora. Marine pilots would visit him, believing that if they donned his hat it would protect them from harm. Today his helicopter does exactly that.

### Hooked for life.

Every part is built with unmatched precision to ensure the safety of our pilots and passengers.

### "Over here!"

There's thermal imaging available that allows rescuers to find people they can't see.

### X2 Technology.™

Stay tuned for this new technology, which will enable us to fly later this year at 250 knots, 60% faster than today's helicopters.

9 seats or 19 seats  
or 23 seats;  
whatever suits you.

### Ambidextrous.

There are almost no right or left-hand parts. Essentially all are universal for ease of replacement and reduced inventories.

## YOU DON'T HAVE TO UNDERSTAND EVERYTHING WE DO TO PROFIT FROM IT.

It's our helicopters that saved 44,179 people from disaster sites last year or our fuel that will lessen dependency on oil tomorrow, it's United Technologies at work. Where would passion, precision, and cool stuff come together like this? To see other incredible United Technologies, go to [utc.com/curious](http://utc.com/curious).

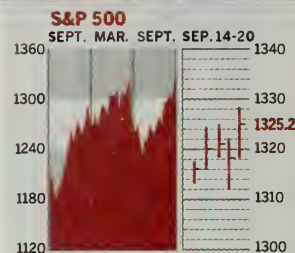


**United Technologies**

You can see everything from here.



## STOCKS



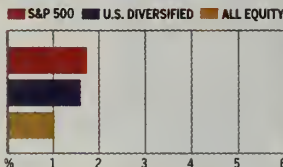
### COMMENTARY

Stockholders had occasions to smile this week. The S&P 500 reached a five-year high of 1328.53. The Dow traded within 110 points of its all-time high and tech stocks lifted the NASDAQ 1.1%. Credit upbeat earnings, a calm Federal Reserve and falling oil prices. But energy speculators turned lachrymose as a hedge fund imploded and oil, gas, and coal stocks fell.

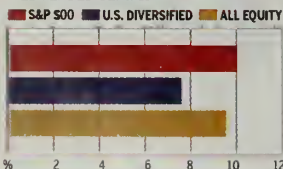
Data: Bloomberg Financial Markets, Reuters

## MUTUAL FUNDS

### 4-WEEK TOTAL RETURN WEEK ENDED SEPT. 19



### 52-WEEK TOTAL RETURN WEEK ENDED SEPT. 19



Data: Standard & Poor's

## U.S. MARKETS

|                       | SEPT. 20 | WEEK | YEAR TO DATE | LAST 12 MONTHS |
|-----------------------|----------|------|--------------|----------------|
| S&P 500               | 1325.2   | 0.5  | 6.2          | 8.5            |
| Dow Jones Industrials | 11,613.2 | 0.6  | 8.4          | 10.8           |
| NASDAQ Composite      | 2252.9   | 1.1  | 2.2          | 5.7            |
| S&P MidCap 400        | 753.4    | -0.5 | 2.1          | 6.8            |
| S&P SmallCap 600      | 376.1    | 0.3  | 7.2          | 8.9            |
| DJ Wilshire 5000      | 13,241.4 | 0.4  | 6.0          | 8.6            |

## SECTORS

|                      | SEPT. 20 | WEEK | YEAR TO DATE | LAST 12 MONTHS |
|----------------------|----------|------|--------------|----------------|
| BusinessWeek 50*     | 745.9    | 0.4  | 0.6          | 0.2            |
| BW Info Tech 100**   | 405.0    | 1.9  | 6.5          | 10.7           |
| S&P/Citigroup Growth | 616.2    | 0.6  | 3.3          | 5.7            |
| S&P/Citigroup Value  | 706.8    | 0.5  | 9.2          | 11.5           |
| S&P Energy           | 390.4    | -3.2 | 4.7          | -2.9           |
| S&P Financials       | 462.6    | 1.3  | 8.5          | 16.3           |
| S&P REIT             | 184.1    | -0.1 | 20.3         | 20.7           |
| S&P Transportation   | 252.2    | -0.4 | 1.0          | 19.4           |
| S&P Utilities        | 170.8    | -0.6 | 7.0          | 0.9            |
| GSTI Internet        | 171.5    | -1.6 | -16.4        | -1.5           |
| PSE Technology       | 829.8    | 1.3  | -0.8         | 2.0            |

\*Mar. 19, 1999=1000 \*\*Feb. 7, 2000=1000

## GLOBAL MARKETS

|                             | SEPT. 20 | WEEK | YEAR TO DATE | % CHANG |
|-----------------------------|----------|------|--------------|---------|
| S&P Euro Plus (U.S. Dollar) | 1770.4   | 1.1  | 17.1         |         |
| London (FT-SE 100)          | 5866.2   | -0.4 | 4.4          |         |
| Paris (CAC 40)              | 5192.7   | 1.1  | 10.1         |         |
| Frankfurt (DAX)             | 5954.4   | 0.8  | 10.1         |         |
| Tokyo (NIKKEI 225)          | 15,718.7 | -0.2 | -2.4         |         |
| Hong Kong (Hang Seng)       | 17,513.0 | 1.8  | 17.7         |         |
| Toronto (S&P/TSX Composite) | 11,635.4 | -1.2 | 3.2          |         |
| Mexico City (IPC)           | 21,841.5 | 2.4  | 22.7         |         |

## FUNDAMENTALS

|                                      | SEPT. 19 | WEEK AGO | YE |
|--------------------------------------|----------|----------|----|
| S&P 500 Dividend Yield               | 1.84%    | 1.84%    | 2  |
| S&P 500 P/E Ratio (Trailing 12 mos.) | 17.4     | 17.3     | 1  |
| S&P 500 P/E Ratio (Next 12 mos.)*    | 14.4     | 14.4     | 1  |
| First Call Earnings Revision*        | -0.80%   | -1.42%   | 1  |

\*First Ca

## TECHNICAL INDICATORS

|                                       | SEPT. 19 | WEEK AGO | R  |
|---------------------------------------|----------|----------|----|
| S&P 500 200-day average               | 1280.2   | 1278.8   | Pe |
| Stocks above 200-day average          | 53.0%    | 55.0%    | N  |
| Options: Put/call ratio               | 0.81     | 0.93     | Pe |
| Insiders: Vickers NYSE Sell/buy ratio | 3.46     | 3.29     | Ne |

## BEST-PERFORMING GROUPS

|                          | LAST MONTH % | LAST 12 MONTHS % |
|--------------------------|--------------|------------------|
| Tires & Rubber           | 25.7         | 72.9             |
| Food Wholesalers         | 13.5         | 68.4             |
| IT Consulting            | 11.5         | 53.3             |
| Department Stores        | 10.6         | 36.9             |
| Genl. Merchandise Chains | 10.4         | 36.4             |

## WORST-PERFORMING GROUPS

|                       | LAST MONTH % | M                    |
|-----------------------|--------------|----------------------|
| Coal                  | -26.0        | Homebuilding         |
| Oil & Gas Refining    | -22.0        | Educational Services |
| Oil & Gas Equip.      | -15.3        | Internet Retailers   |
| Gold Mining           | -14.8        | Internet Software    |
| Constr. & Engineering | -13.2        | IT Consulting        |

## EQUITY FUND CATEGORIES

| 4-WEEK TOTAL RETURN      | %    | 52-WEEK TOTAL RETURN    | %    |
|--------------------------|------|-------------------------|------|
| <b>LEADERS</b>           |      | <b>LEADERS</b>          |      |
| Communications           | 4.3  | Precious Metals         | 34.2 |
| Technology               | 4.1  | Latin America           | 32.1 |
| Real Estate              | 3.6  | Real Estate             | 25.9 |
| Pacific/Asia ex-Japan    | 2.4  | Diversified Emrg. Mkts. | 24.1 |
| <b>LAGGARDS</b>          |      | <b>LAGGARDS</b>         |      |
| Precious Metals          | -9.9 | Health                  | 2.8  |
| Natural Resources        | -8.8 | Natural Resources       | 3.3  |
| Japan                    | -3.8 | Large-cap Growth        | 4.6  |
| Diversified Pacific/Asia | -1.7 | Technology              | 5.0  |

## EQUITY FUNDS

| 4-WEEK TOTAL RETURN         | %     | 52-WEEK TOTAL RETURN      | %     |
|-----------------------------|-------|---------------------------|-------|
| <b>LEADERS</b>              |       | <b>LEADERS</b>            |       |
| ProFds. Sh. Prc. Mtls. Inv. | 18.9  | U.S. Global Invsr. Gold   | 59.8  |
| ProFds. Sh. Oil & Gas Inv.  | 10.4  | ING Russia A              | 59.5  |
| ProFds. Mble. Tlcmms. Inv.  | 10.4  | U.S. Gbl. Invs. Prc. Mnl. | 55.8  |
| Ehrenkrantz Growth          | 9.2   | Midas                     | 54.3  |
| <b>LAGGARDS</b>             |       | <b>LAGGARDS</b>           |       |
| ProFds. Prc. Mtls. Inv.     | -24.2 | Ameritor Investment       | -81.8 |
| DireXion Cmmdty. Bull 2X    | -15.4 | American Heritage Grth.   | -50.0 |
| Rydex Commodities H         | -15.2 | American Heritage         | -22.2 |
| Merrill Lynch RI. Invmnt. C | -14.6 | Rydex Commodities H       | -22.0 |

## INTEREST RATES

### KEY RATES

|                         | SEPT. 20 | WEEK AGO | YI |
|-------------------------|----------|----------|----|
| Money Market Funds      | 4.84%    | 4.84%    |    |
| 90-Day Treasury Bills   | 4.92     | 4.90     |    |
| 2-Year Treasury Notes   | 4.82     | 4.79     |    |
| 10-Year Treasury Notes  | 4.73     | 4.76     |    |
| 30-Year Treasury Bonds  | 4.85     | 4.89     |    |
| 30-Year Fixed Mortgage† | 6.20     | 6.16     |    |

†Banks Quo

## BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

|                       | 10-YR. BOND | 30-YR |
|-----------------------|-------------|-------|
| General Obligations   | 3.80%       |       |
| Taxable Equivalent    | 5.43        |       |
| Insured Revenue Bonds | 3.88        |       |
| Taxable Equivalent    | 5.54        |       |

## THE WEEK AHEAD

### EXISTING HOME SALES Monday, Sept. 25, 10 a.m. EDT »

Existing home sales in August are forecast to have edged down a little more, to an annual rate of 6.3 million units. That's the median forecast of economists surveyed by Action Economics. In July, sales slowed to a rate of 6.33 million.

### CONSUMER CONFIDENCE

Tuesday, Sept. 26, 10 a.m. EDT » The Conference Board's September consumer confidence

index most likely rebounded to 102.1, from 99.6 in August. Early readings on September consumer sentiment revealed a sense of relief over lower gasoline prices.

### DURABLE GOODS ORDERS

Wednesday, Sept. 27, 8:30 a.m. EDT » Durable goods orders in August probably bounced back with a 1% increase. New orders fell 2.5% in July as orders of civilian aircraft and fabricated metal products dropped.

### NEW HOME SALES Wednesday, Sept. 27, 10 a.m. EDT »

New-home sales likely inched down to an annual pace of 1.06 million units in August, from 1.07 million in July.

### PERSONAL INCOME Friday, Sept. 29, 8:30 a.m. EDT »

August personal income is expected to have climbed 0.4%, following a 0.5% gain in July. Consumer spending probably rose 0.3%, on slower auto sales, after jumping 0.8% in the prior period.

The BusinessWeek production rose to 284.4 for the week Sept. 9 and stood 11.8% above year-ago level. Before calculating the four-week moving average, index eased to 284.9.

## BusinessWeek on

For the BW50, more investment data, and the components of the production index visit [www.businessweek.com/extras](http://www.businessweek.com/extras)

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- Curt Hecht, GM Planworks
- Linda Perry-Lube, Microsoft
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*\*Registration includes entrance to the SEMA exhibits*

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- Site Search and Navigation
- Sales Integration: Linking Shoppers from the Dealer site to the Store
- Attracting Traffic to the OEM Site
- Evolution of Marketing Plans
- Effective Video Content
- Demonstrating Vehicle Quality and Technologies Online
- Best Practices: Leads & Customers at the Dealership
- Consumer Generated Media

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We examine how the real estate slowdown could slam the stock market.

### Military Memorabilia:

Learn how World War II artifacts are valued and how to start collecting on any budget.

**Got Gold?:** Tips on how to get the best price when selling your gold jewelry and coins.

### Destination CEO: Meet

Jack Pelton of Cessna Aircraft, whose innovative ideas about affordable jet travel are taking off.

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A background image featuring a close-up of a car's steering wheel and dashboard, with the European Union flag (a circle of twelve gold stars on a blue background) visible in the lower-left corner.

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# They Do It Their Way

**MAVERICKS AT WORK** Why the Most Original Minds in Business Win  
By William C. Taylor and Polly LaBarre; Morrow; 316pp; \$26.95

Arkadi Kuhlmann, the founder and CEO of online bank ING Direct USA, isn't your typical bank CEO. He refuses to offer credit cards to his customers. And every year, he "fires" more than 3,500 high-maintenance account holders who do such things as make too many calls to customer service. That helps keep costs

low and lets him pass savings on to those who get his company's just-the-basics philosophy.

But banking's "bad guy," as Kuhlmann has called himself, is really one of the good ones—an innovative, unconventional leader who runs his business by his values and turns tradition on its head. At least so say William C. Taylor and Polly LaBarre in *Mavericks at Work: Why the Most Original Minds in Business Win*, a book that profiles Kuhlmann and other nonconformist business leaders. *Mavericks* offers compelling evidence that differentiation—"strategy as originality," in the words of Taylor and LaBarre—is crucial to the distinctive customer experiences and breakthrough practices that lead to growth.

The volume has dozens of case studies of leaders who eschew tradition and adopt creative tactics. That shouldn't come as a surprise, since the authors are both former editors of a magazine that focuses on such folks, *Fast Company*. (Full disclosure: This reviewer also once worked there, after Taylor and LaBarre had departed.) With a few exceptions—what business book would be complete without a Southwest Airlines anecdote?—they describe organizations that will be fresh to readers of other books on management, including HBO, Jones Soda, and the Edinburgh Fringe Festival.

For example, consider retail chain Anthropologie, a unit of Urban Outfitters that appeals to niche customers' sense of identity with uniquely designed stores, upscale bohemian-chic clothing, and one-of-a-kind items. Many of Anthropologie's wares are the product of global treks by the brand's "de-facto chief product anthropologist," Keith Johnson. After five years of service, senior employees in the field, such as district managers, can go along on Johnson's four-to-eight-week continent-hopping buying trips.

Wieden + Kennedy, the advertising agency behind the famous "Just Do It" Nike ads, founded an in-house school to bring fresh voices to the agency. Although aspiring creatives pay tuition, they work on real campaigns. Moreover, in 2000, W+K built a new headquarters and invited the Portland

Institute for Contemporary Art, four nonprofits, a city lect series, and an artist-in-residence program to set up shop within its doors. The goal was the same: to spark inspiration.

Taylor and LaBarre also write approvingly of Pixar, which, unlike most studios, favors using a close group of collaborators who work together over the long term rather than gathering a different mix of people for each new film. build those relationships, "Pixar University" runs classes any employee—accountants, security guards, marketers, of course, animators—in subjects ranging from sculpting painting to creative writing and belly dancing. The idea? teach employees new skills, of course, but more important

to bring together "a diverse group of people to sit in a room, try new things, mess up, get embarrassed, and learn how to bounce back—together," the authors write.

*Mavericks* is wide-ranging: Taylor and LaBarre muse on everything from open-source innovation to the value of open-book management. Yet the book lacks a cohesive big new idea beyond emphasizing originality and innovation. As a result, the case studies can feel like a string of magazine-article fragments. Indeed, more than half of the companies in the book have been subjects of *Fast Company* stories.

To their credit, Taylor and LaBarre have some caveats about their "mavericks" as

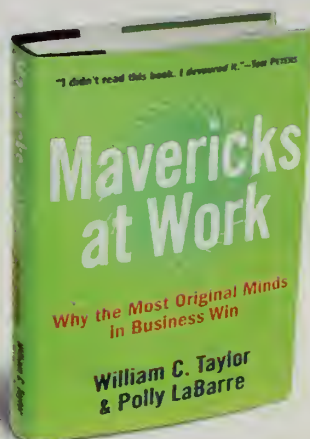
describe cases where a few have gone astray. For example, they note that service-friar Commerce Bancorp "suffered a very public black eye" when two executives were convicted on conspiracy counts. Still, these missteps are sometimes referred to in footnotes, and the book's rosy, enthusiastic tone may grate on some readers. "There's nothing so exhilarating as being an eyewitness to the future,"

## The authors argue that turning tradition on its head can lead to growth

authors gush. "We immersed ourselves in organizations have shaped the course of their industries by reshaping a sense of what's possible."

But others may be inspired or at least pluck an idea or two. In the introduction, Taylor and LaBarre say they will consider the book a success if it "opens your eyes, engages your imagination, and encourages you to think bigger and aim higher." On that level, with many readers managing a business world plagued by risk-aversion, conformity, and copycat benchmarking, *Mavericks* is likely to succeed. ■

—By Jena McGregor



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## When Boards Get Blabby

The current imbroglio involving the Hewlett-Packard Co. board of directors illustrates a problem that could threaten to wipe out much of the recent, hard-won improvement in the quality of corporate governance. Believe it or not, I'm not referring to how the HP leaks were investigated. I'm talking about the long-running leaks that prompted the investigation.

I'm sure the combined investigative powers of the Justice Dept., the Securities & Exchange Commission, the California Attorney General's office, and the U.S. Congress—all of which have expressed interest in the case—will get to the bottom of who did what and whether anyone broke any laws in the course of investigating the leaks. What I don't see is any equivalent interest in the critical issue of boardroom leaks: how they can disrupt the work of boards and do a disservice to shareholders. Quite the contrary, writers in some leading business publications are extolling the virtues of leakers and leaking, arguing that those who break the boardroom's code of silence are acting in the best interests of shareholders.

That's nonsense.

As someone who has spent years working with boards and chief executives to help them improve the quality of corporate governance, I firmly believe that boardroom leaking is not only morally reprehensible but also a major obstacle to a board's effective performance. Here's why:

First, to function effectively, boards must engage in open discourse that challenges management's thinking and holds members accountable for their performance. When boards sit silent and passive, keeping misgivings to themselves, bad things can happen. Boards learned from the Enron-era scandals that to do their job effectively, directors must feel free to ask dumb questions, float unorthodox ideas, question management's judgment, and challenge a CEO's performance.

I'm thrilled we're finally seeing the board evolve from a courtly gentlemen's club to an active business team working to safeguard shareholders' interests. And the most visible evidence of change is the sharply altered give-and-take within the boardroom. More and more, we're seeing the kind of unfettered debate that can raise questions about a flawed strategy before it's too late, or help a CEO improve performance while there's still time to get back on track.

I know firsthand that these conversations do not take place on boards where members suspect their colleagues will leave the meeting and immediately leak a heavily edited, one-sided, self-serving version of what transpired. I also have seen

situations where the bond of trust has become so unraveled that CEOs have become reluctant to raise important issues with the entire board in the room. And with good reason.

Then there's the issue of timing. Unlike the days when management would present the board with complex decisions to be rubber-stamped, today's most effective boards get involved with issues such as corporate strategy, mergers, or executive performance evaluations while they can still make a difference. But once a leaker decides to publicly disclose those discussions, it's game over. Pressure mounts, people get squeamish,

alternatives vanish. Perhaps a CEO who has succeeded over time gets fired because time has prematurely run out. In other words, the leaker, in an astounding act of hubris, taken it upon himself to derail the board's deliberative process.

Without question, the board has an absolute duty to communicate actions and decisions to the shareholders in a timely manner. But to assert that full and immediate disclosure of all of a board's deliberations—including preliminary discussions far in advance of any decision

is in shareholders' best interests is simply wrong.

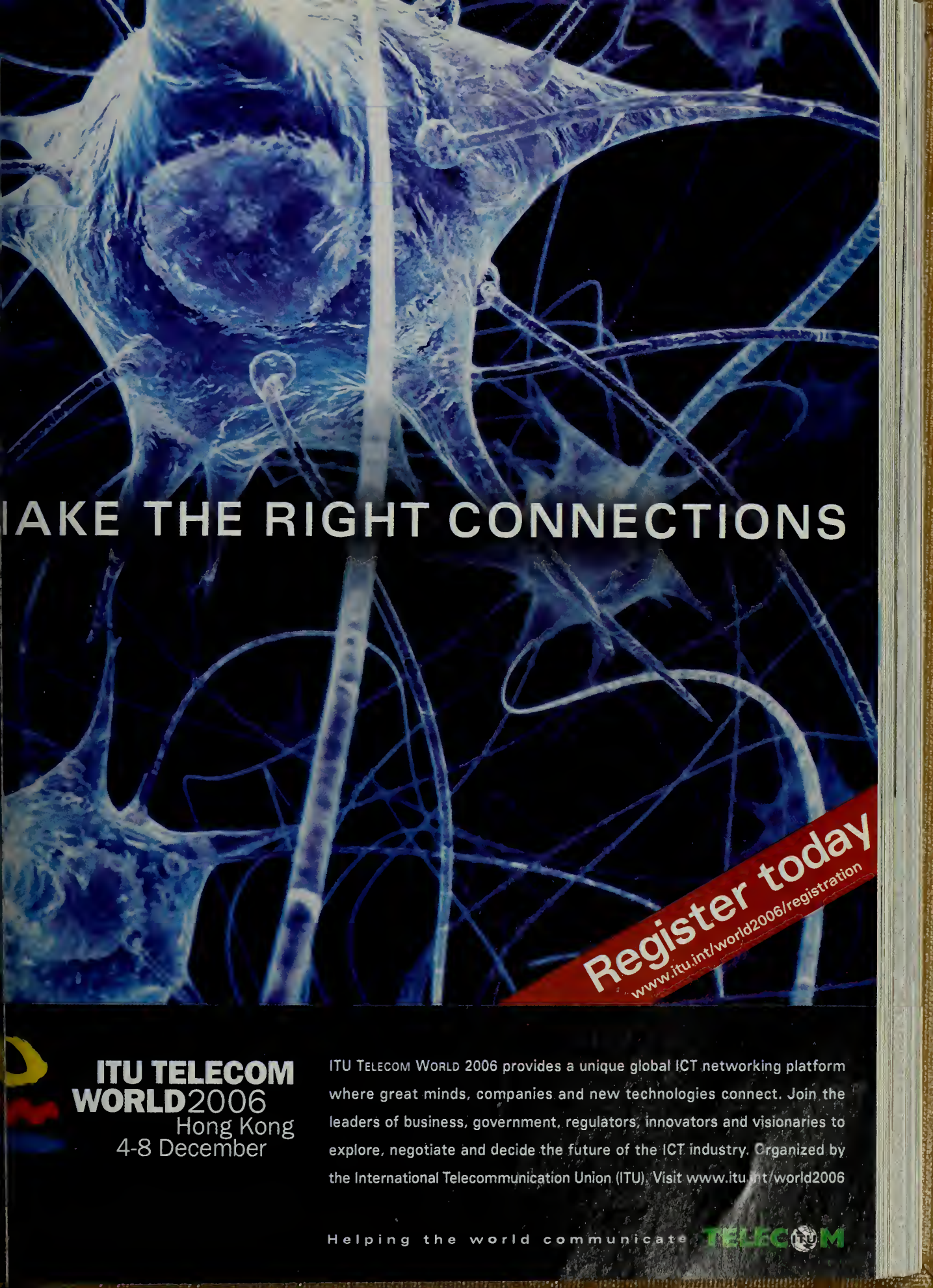
Of course, there is an honorable course of action open to directors who believe they've exhausted every option for properly influencing their boards: They can quit. I don't suggest this lightly. But there are cases when a director is at odds with the rest of the board that the only honorable thing to do is to resign—loudly, publicly, and with a full explanation of the disagreement. That's what should have happened at HP.

None of this is intended to condone or excuse excesses in the HP investigation. But ignoring the equally important issue of board leaks isn't the answer. Boards have a duty to provide a secure environment for doing their business with sufficient confidentiality. They owe that to their directors. More important, they owe that to shareholders. ■

**Leakers inhibit candid debate by hijacking a board's deliberative process**

**David A. Nadler**, chairman of Mercer Delta Consulting, co-editor of *Building Better Boards: A Blueprint for Effective Governance*.



An abstract graphic featuring a complex network of glowing blue and white lines and nodes, resembling a neural network or a global communication web, set against a dark background.

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## The Case for 20-70-10

**I really support differentiation—ranking employees into performance categories of the top 20%, middle 70%, and bottom 10%, and then managing them “up or out” accordingly. But don’t companies face all sorts of resistance when they try to implement this system?**

—Yoshihisa Tanizawa, Kuala Lumpur, Malaysia

Resistance may be too soft a word. Yes, differentiation has its advocates, and even its hard core devotees, but no other management practice that we talk or write about ignites the same firestorm of controversy.

So thanks for asking about it. Your question gives us a chance to sort differentiation myth from reality. Done right, differentiation is not, for instance, “rank and yank,” with its purported public firings of stunned victims once a year. Nor is it cruel, corrupted by favoritism, and culturally inappropriate.

What is it, then? Very simply, differentiation is based on the principle that the team with the best players wins. If you don’t agree with that, then differentiation will never make sense to you. But if you do, then differentiation provides a methodology for making that principle spring to life. How? By rewarding stars in an outsized way that is both soul-satisfying and financially satisfying; by developing “the middle 70” with training and coaching; and by moving out bottom-tier performers so better talent can be brought in.

Basically, differentiation is a way to build meritocracies and continually raise the performance bar, increasing a company’s competitiveness with every upward notch.

So why does it spark “all sorts of resistance,” as you so accurately suggest? By far the most common reason given is that differentiation is cruel.

We’d make the exact opposite case. Look at it this way. Because of differentiation’s performance appraisals, people know where they stand. Maybe the news is not always good, but it does allow them to control their own destinies.

**COMPARE THAT WITH COMPANIES** where managers, in the name of kindness, allow people, and particularly underperformers, to plod along for years. Then a downturn occurs. Middle-aged underperformers are always the first to get the ax. One by one, their manager calls them in for a conversation that usually goes like this:

“Joe, I’m afraid you have to leave.”

“What! Why me?”

“Well...you were never very good.”

“I’ve been here 20 years. Why didn’t you ever tell me?”

Why not indeed? The employee, years earlier, might have been

able to find a job with a future. Now, at age 45 or 50, he must enter a job market more competitive than ever. That’s cruel.

The “yank” myth of differentiation says the bottom 10% are summarily fired. In reality, that’s rare. More typically, when a person has been in the bottom 10% for a sustained period of time, the manager starts a conversation about moving on. Occasionally, of course, an underperformer doesn’t want to go. But confronted with the cold reality of the organization views them, most people leave of their own accord and very often end up at companies where their skills are a better fit and they are more appreciated.

Moving on to resistance reason No. 2: that differentiation spawns favoritism. The top 20%, it is said, will always be the boss’s insiders and pals. To which we say, that’s possible. But favoritism is a risk in any evaluation system. At least differentiation’s performance reviews, which require quantitative assessments of team members, are a countervailing force.

A third common criticism of differentiation is the continual removal of the bottom 10% eventually forces managers to push out perfectly good employees and thus pits people against one another. But if that thinking is right, why do championship teams replace the bottom of their rosters every year? Because the best organizations, in business as in sports, believe that performance can always improve.

The final reason people resist differentiation is that, even when they see its appeal, they believe it won’t work in their company’s supposedly unique culture. And what culture is that? Well, we’ve heard this objection from people at companies small and large, Japanese and Swedish, growing and shrinking, and in every sector under the sun.

In reality, though, we’ve seen differentiation implemented everywhere. In some situations, it takes more time, or, because of labor laws, it costs more to let people go. But differentiation should never be rushed anyway. Full-fledged implementation cannot—and should not—occur until an appraisal system has been in place for about three years. People have to get used to candid feedback and the concept of pay for performance.

We’re certainly not going to claim that differentiation is perfect. Every management practice has flaws. But we know no better way than differentiation for companies to build better teams. And neither, we have found, do its critics! ■

*Jack and Suzy Welch look forward to answering your question about business, company, or career challenges. Please e-mail them at [thewelchway@businessweek.com](mailto:thewelchway@businessweek.com). For their weekly podcast, go to [www.businessweek.com/search/podcasting.htm](http://www.businessweek.com/search/podcasting.htm)*

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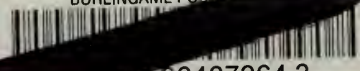
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## THE WALL STREET JOURNAL.

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

LIQUOR BRAND/PRICE\* OUR AWARD

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**Juniper Green Organic** Best  
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Peter Rojas of engadget, a popular blog about tech toys

## Sites Worth Seeing

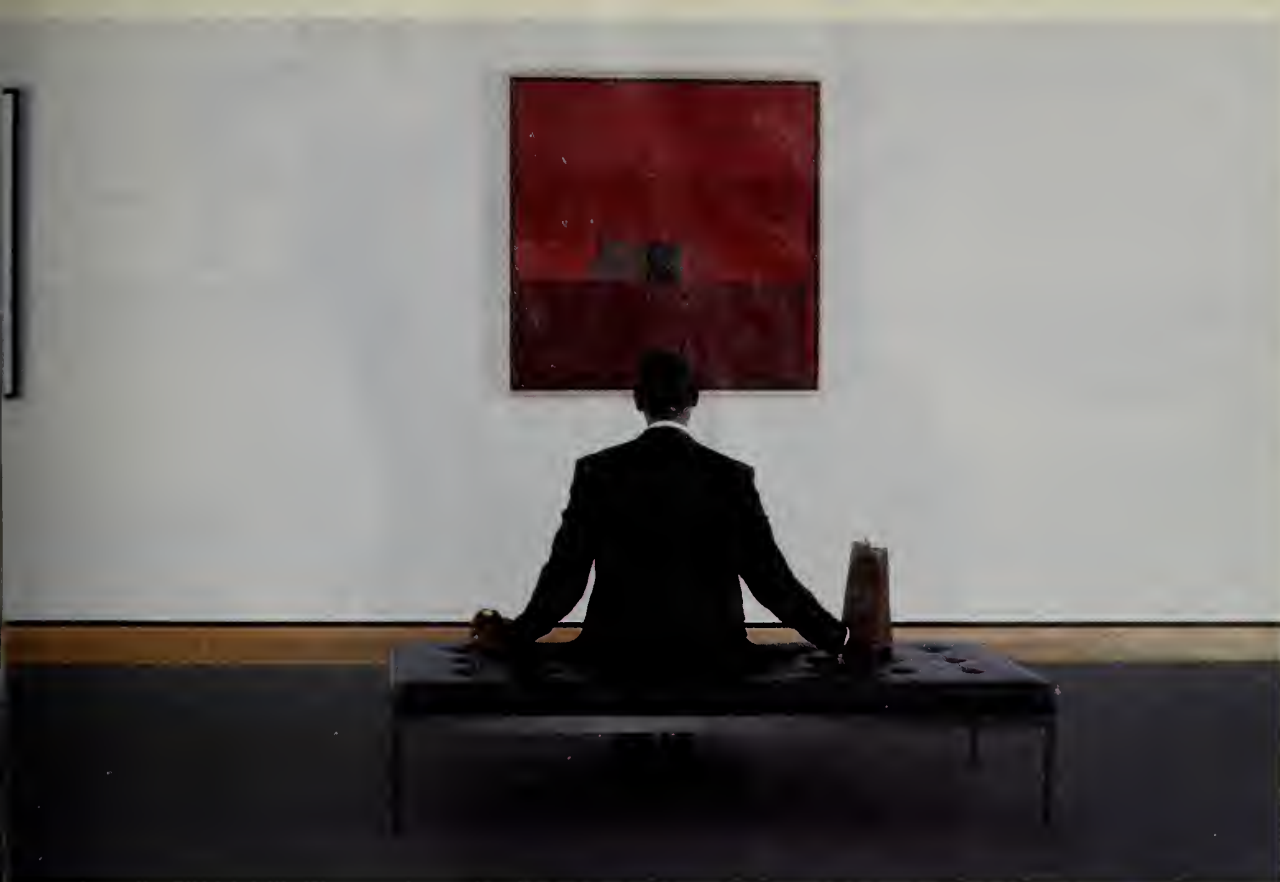
Where do BusinessWeek.com readers like to pass time on the Web? We asked people to vote for their **favorite sites** and they heeded the call in droves. For general news, readers are gaga over Google; for real estate, they're true to Trulia; and for humor, The Onion gets the biggest laughs. These and results in 20 other categories, including health, sports, and music can be found in this year's **Best of the Web** special report. Learn why more people of all ages are flocking to the Internet for entertainment—not just information—and why some market have yet to catch on. Discover a host of new sites aimed specifically at baby boomers, and how startup Six Apart is bracing for **blogging's next wave**. (Hint: It's getting more social and going wireless.) Our slide show will introduce you to the people behind some of the most-read blogs. And find out why our reviewer likes Soapbox, **Microsoft's answer to YouTube** and other video Web sites. For this and more, go to [www.businessweek.com/go/06bestweb](http://www.businessweek.com/go/06bestweb)

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## INVESTMENT ADVICE

and its effect on quality of life



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**"Your family has taken a hit. That calls for mercy."**

U.S. District Judge Kenneth Hoyt on sentencing former Enron CFO Andrew Fastow to a six-year prison term, instead of the original 10 years agreed to in his plea bargain. (His wife already served a one-year sentence).

EDITED BY DEBORAH STEAD

## WIND WEB FRAUD SQUAD FOR ADVERTISERS

**STRATED** by clicking in online advertising—Oct. 2), a group of advertisers and agencies have joined the **Click Forensics** Council to fight the problem more aggressively. by online ad-monitoring **Click Forensics**, members include credit-card giant **Visa**, mortgage firm **LendingTree**, and ad agencies **Carat Fusion**, **Google**, **Yahoo**, and other search engines are now working with the **Interactive Advertising Bureau** to define fraud, and the council has a say. "If Google and



Yahoo are establishing standards for advertising online, advertisers have to be part of the mix," says Robert Pettee, search marketing manager for LendingTree in

Charlotte, N.C. Search-engine advertisers, who pay each time a visitor clicks on an ad, are increasingly worried about the bogus clicks, some of which are generated by clicking software or a network of paid

clickers. That concern may undermine the rapid growth in U.S. online advertising.

Experts estimate 10% to 15% of clicks on search engine ads are fraudulent. Search engine giants say that's an exaggeration and that they catch most bad clicks before advertisers are charged and give refunds for illicit clicks. Some advertisers, it seems, aren't so sure.

—Brian Grow

## THE BIG PICTURE

**MORE THAN** a third of board directors say CEO pay is too high. And almost half say the cure for overcompensation would be to have shareholders approve executive pay plans.

### FACTORS WHO:

|                                                     |     |
|-----------------------------------------------------|-----|
| CEO pay is "too high in most cases"                 | 38% |
| Expect continued increases in CEO cash compensation | 64% |
| CEO pay is generally "in line" with the economy     | 13% |
| Shareholder approval of CEO pay would be best       | 49% |
| to lower it                                         |     |

Survey of 768 directors at 660 publicly traded companies conducted by Heidrick & Struggles Intl. and the University of Southern California's Marshall School of Business.

**NEW ORLEANS,** June 28, 2006. A slow response to Katrina may have hurt America's global ranking



## U.S. COMPETITIVENESS

# Failing on the Fundamentals

**THE U.S. GETS** the hard things right, like market efficiency and innovation, but it messes up the basic stuff, like balancing the budget. In fact, its macroeconomy—with big government deficits and negative personal savings—is worse than those of Nigeria, Peru, Uganda, Venezuela, or Vietnam. So says the **World Economic Forum**, sponsor of the annual glitterati gabfest in the Swiss ski resort of **Davos**. Putting it all together, the forum ranked the U.S. sixth in its Global Competitiveness Index this year, down from first place in 2005. (The U.S. was originally deemed No. 2 last year, but the results were restated using a new methodology.)

Like any other ranking, the forum's index invites controversy. China is only No. 54 among 125 nations, behind Costa Rica. (It got demerits for its weak banks and courts.) The top five: Switzerland, Finland, Sweden, Denmark, and Singapore—neat and tidy nations where all the budgets are strong and all the savings rates are above average.

The index uses statistics and a survey of 11,000 business executives worldwide. Dragging down the U.S. score, besides macroeconomic factors: high infant mortality, relatively low life expectancy, and poor marks from the executives on government effectiveness, which the forum says may reflect the bungled response to Hurricane Katrina.

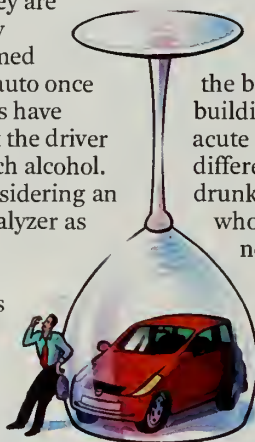
—Peter Coy



## AUTO NATION CARS THAT KNOW WHEN TO SAY WHEN

**IF FRIENDS** don't let friends drive drunk, should cars? Recently, **Nissan** and **Toyota** revealed that they are researching new technologies aimed at disabling an auto once the car's systems have determined that the driver has had too much alcohol.

Nissan is considering an onboard breathalyzer as well as more sophisticated systems, such as using a camera to monitor driver behavior. Not to be outdone, Toyota research and development chief Kazuo Okamoto confirmed on Sept. 21 that the auto



giant is researching not only the breathalyzer option but also a way of testing for alcohol through the steering wheel, using onboard computers to monitor driving style.

A foolproof system looks to be a ways off. One problem: ensuring that a drunk driver won't be able to enlist someone else to take the breath test. Another is building systems acute enough to differentiate between drunk drivers and those who drive erratically, but not dangerously. Then there are legal issues.

What if a drunk driver who harms himself or another sues a carmaker, claiming he only drove because his car allowed it? "I have to say we're still at an R&D stage," says Toyota's Okamoto.

—Ian Rowley



## SEARCHING FOR SPIES

**NO, IT'S NOT** a spoof. The CIA is advertising on the cable channel Comedy Central as part of a recruiting effort for its National Clandestine Service. The ads, which began in mid-August and will run until at least mid-October in the New York, L.A., Detroit, and Chicago markets (where they're in movie theaters, too), feature a diverse group of twentysomethings who have presumably answered "yes" to the question posed in the voice-over: "Are you ready for a world...of ambiguity and adventure?" The agency says it didn't target Comedy Central, noting that the ad packages it buys allow cable providers to pick from an array of channels. Still, online résumés are up at the agency since August, says spokesperson Michelle Neff, with 2,800 coming in weekly.

—Lindsey Gera

## BLOGSPOTTING INNOVATION HUB [innovation.corante.com/network](http://innovation.corante.com/network)

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—Elizabeth Woyke

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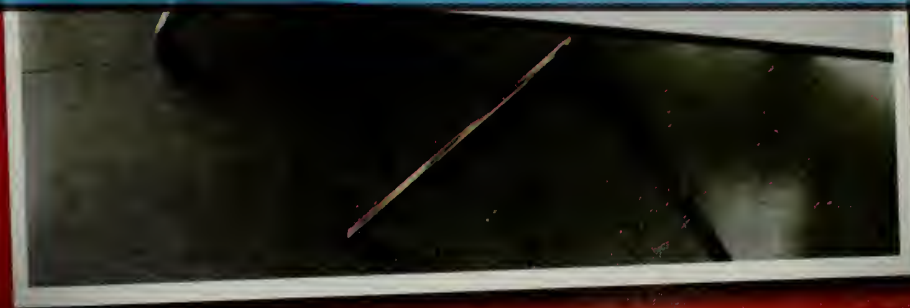


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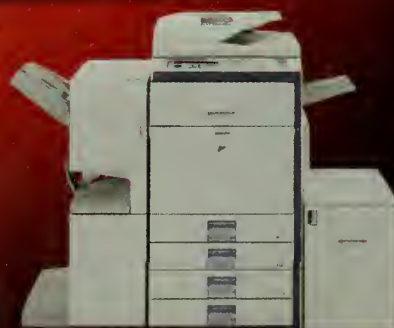
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## BOGEY MEN



## WHERE CEOs ARE COMING UP SHORT

Maybe chief executives are working extra hard these days to earn those huge pay packages: They're spending less time on the links, according to *Golf Digest's* latest biannual survey of CEO golfers. And it shows: **Many who made the magazine's top 200 CEO golfers in 2004 report their games have since worsened.**

Among the CEOs with rising handicaps (the average number of strokes they typically shoot above par) are discount broker Charles Schwab, Jeff Immelt of General Electric, Robert Walter of Cardinal Health, and John Tyson of Tyson Foods. A handful of top CEO golfers such as Comcast chief Brian Roberts haven't posted any golf rounds since 2005.

Some CEOs did find the time to improve their game. Terry Lundgren, head of Federated Department Stores, slashed his handicap from 18.0 to 10.9, enough to vault him from 179th to 91st in the rankings. Federated shareholders needn't worry, though: The company's shares have soared 87% during that same stretch.

—Dean Foust

## CAUSES

## PROSTATE CANCER'S HIGHER PROFILE

### THE PUBLIC-AWARENESS

campaign about prostate cancer may be taking off. The publicity and corporate sponsorships aimed at fighting the disease have lagged far behind support for breast cancer prevention and research. "Men don't really like to take care of their health or advocate for themselves," says Jamie Bearse, spokesman for the **National Prostate Cancer Coalition**. "That puts the cause at a bit of a disadvantage."

For years, prostate cancer has had its own month (September), color (blue), and two major nonprofits (NPCC and the Michael Milken-founded **Prostate Cancer Foundation**). But the campaign has had difficulty recruiting sponsors outside of longtime supporters like **Safeway** and **Major League Baseball**, which also dedicates one game a year, around



Father's Day, to prostate cancer awareness. And in recent surveys, only 15% of men identify the campaign's blue ribbon with prostate cancer, up from 8% earlier. Indeed, because many men are loath to wear such accessories, NPCC also sells bracelets with the phrase "Do it for Dad" to appeal to wives and children. And PCF sells a lapel pin in the shape of a necktie, not a looped ribbon.

Recently, though, there has been "an enormous difference" in the level of awareness and funding, says Leslie Michelson, head of Milken's PCF, as prominent prostate cancer survivors like New York's Rudy Giuliani and Colin Powell get active in the cause. PCF estimates its individual, foundation, and

corporate donors will reach 19,000 in 2006, from 4,500 in 2004.

The higher profile has helped attract nearly a dozen more corporate campaign partners. This year, **Gillette** launched the "Prostate Cancer Challenge," which helps provide free screenings. And NPCC is working with, among others, **Grolsch Beer**, whose "Proktoberfests" feature celebrity-decorated beer bottles auctioned off for the cause.

Brands are rolling out affiliated products, too. Gillette plans to add a logo to its Mach3 and Fusion razor packages. And in November, PCF will offer branded wristbands with **NBA**, signed by players like Jason Kidd and LeBron James.

—Elizabeth W.

## CHINESE TAKEOUT COUNTING CASH, NOT VOTES

**GIVEN THE** bad publicity plaguing **Diebold's** electronic voting machines in the U.S., the \$2.6 billion company may feel it's a relief to do business in China, which won't be holding elections anytime soon. Diebold is hitching its fortunes to the rapid growth of self-service banking on the mainland, selling thousands of its ATMs to Chinese banks. "China is the most important market for us as we look into the future," says President

and CEO Thomas W. Swidarski, who predicts 20% to 30% growth for those ATM sales in the next few years. The goal: a \$1 billion Chinese sales operation in 7 to 10 years.

Key to reaching that goal, the company says, is maintaining a solid reputation for ATM service and security in China, where it has a 63-city service team. Diebold says its safety features (including a sensor to detect whether a device for information



skimming, a common scam in China, is attached to an ATM's card slot) make its machines safer than those

competitors. Will concerns about Diebold voting machines in the runup to American elections raise questions among China's avid netizens about ATM security? "Our technology speaks for itself,"

says Swidarski, who adds "never" has a Chinese banker asked about the voting machine flap in the U.S.

—Dexter R.



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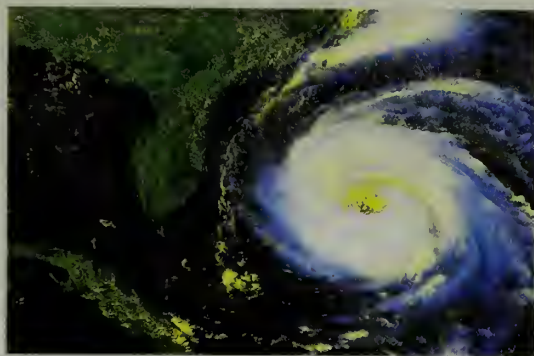
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# HOMELAND SECURITY IS STRENGTHENING OUR NORTHERN AND SOUTHERN BORDERS. UNFORTUNATELY, THE BIGGEST THREAT WE FACE MAY ATTACK FROM THE EAST.

Last year, a record number of hurricanes formed in the Atlantic basin. This wasn't just bad luck. There's actually a scientific reason behind it: The Atlantic Ocean has become warmer than average. Scientists say this temperature cycle could bring us more devastating hurricanes for at least the next decade. As of 2004, the property value in the 18 East and Gulf Coast states totaled \$6.9 trillion. That's over half the entire U.S. GDP.

**We can't afford to leave ourselves exposed like this any longer.**

Today, Congress is working with state and local officials and the private sector to create a financially responsible solution to prepare and protect Americans from future natural catastrophes like hurricanes and earthquakes. H.R. 4366 and S. 3117 use insurance premiums — not tax dollars —

to create a financial backstop against disaster and help Americans better prepare themselves for these events. It is truly a cause worthy of your and every American's support.

**IT'S TIME TO STRENGTHEN OUR DEFENSES.**

Visit [www.protectingamerica.org](http://www.protectingamerica.org) and urge Congress to get our country ready for the next big attack.



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Great article, if I were 22 again. How about a feature on... 'The 50 best employers for downsized, middle-aged workers'...?"

—Peter Doherty Jr.  
 Enfield, Conn.

### LAUNCHING A CAREER: INSIGHTS AND INDIGNATION

**YOUR CRITERIA FOR** "The best places to launch a career" (Cover Story, Sept. 18) include opinions of career services personnel regarding campus buzz, questionnaires filled out by companies, and surveys of undergraduate students, almost without regard to which companies actually launched the most successful careers.

Isn't it surprising to you that General Electric Co. is only No. 8, and Procter & Gamble Co., which launched the careers of Jeff Immelt, Steve Ballmer, Jim McNerney, Meg Whitman, and a host of others, isn't even mentioned? Ditto McKinsey. In future surveys, consider the possibility that a better metric for the best place to launch a career in business might be past successful arrivals at the CEO destination.

—Gary M. Stibel, CEO

New England Consulting Group  
 Westport, Conn.

Editor's note: P&G and McKinsey were invited to participate in *BusinessWeek's* survey, but neither company agreed to provide data.

"THE BEST PLACES to launch a career" focused on national large players and did not discuss the advantages of medium-

size firms. I launched my professional career in a large public company doing human resource consulting. My scope of work was limited. I grew to understand 100% of what I was working on, which was only about 15% of the HR field I learned after moving to private-sector medium-size companies that although your client load may drop 95%, your scope of work expands tenfold.

A strong midsize organization (200 plus employees) with good infrastructure and a wide scope of work will provide graduates as fast as, or faster, than large firms. The added bonus of personal interaction with senior management and exposure to local markets and business leaders can help in generating the contacts needed when it is time to move.

—Paul T. S.

Director of Human Resources  
 Nordarse & Associates  
 Winter Park, Fla.

AS THE PROUD parent of two children in the "Millennial" generation, I am concerned about this generation's outlook on what a job and career must offer. It strikes me as unsettling that "personal fulfillment," vacation time, job flexibility,

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## ReadersReport

project satisfaction is what tops the list for their entry-level positions. Whatever happened to hard work, learning an industry/business, and asking what skills and value you must bring to an employer that is providing you with development, experience, and compensation?

Numerous *BusinessWeek* stories have debated the struggle to maintain global competitiveness and stem the tide of global outsourcing at many companies. I am afraid if your predictions come true, this Millennial generation will see their careers continue to move overseas and they will lament that they are the first generation that has been unable to truly enjoy the U.S. lifestyle provided by the many creative yet hard-working generations before them.

—Scott Hennessy  
Memphis, Tenn.

I AM NOT a “young college grad,” nor am I a “young job seeker.” I am in my early 40s and, after a 20-year absence, am back in school to finish my degree. I’m not alone. The average age of the American college student is on the rise. Whether for financial reasons, relationships, or lack of a clear goal, people currently in the workplace are discovering that options for growth are limited without any type of degree. According to the U.S. Education Dept., 26% of adults completed a four-year degree after the age of 25—a 5% increase from 10 years ago. In the future, don’t forget the “older” crowd. There are more of us than you know, and since we’re already well into debt with mortgages, car payments, insurance premiums, etc., we need all the help we can get!

—Helene Kremer  
San Ramon, Calif.

“MONEY IS LESS important than personal fulfillment on the job,” say 78% of the teens interviewed for your cover story. As a 50-ish occupational therapist, community college instructor, mother, and grandmother, I feel sad and concerned for today’s young adults entering the workforce. People of any age should seek balance in their life and not expect their employment to satisfy all their needs. A job is merely one piece of who we are and what we do.

—Debra L. Karplus  
Champaign, Ill.

WE READ WITH INTEREST your cover story on the 50 best places to launch a career. The U.S. Nuclear Regulatory Commission has been ranked as the top-rated federal regulatory agency at which to work, and the No. 3 employer in the en-

### CORRECTIONS & CLARIFICATIONS

In “A shot in the arm for Cleveland BioLabs (Inside Wall Street, Oct. 2), Curaxins is in phase 2 trials, not phase 3, and has killed human cancer cells transplanted into animals, not primates. And Cleveland Clinic will provide the equivalent of \$5 million in research and infrastructure.

tire federal government by the Partnership for Public Service and American University’s Institute for the Study of Public Policy Implementation. The nuclear fire is growing rapidly.

Check us out. We’re a great place work. And we’re hiring significant numbers of entry-level employees.

—Eliot Bren

Director of Public Aff

The Nuclear Regulatory Commiss

Rockville, M

GREAT ARTICLE, if I were 22 again. Hope about a feature on what all too many of us in today’s working world need, namely: “The 50 best employers for downsized middle-aged workers with lots of skills and life experiences”?

—Peter Doherty  
Enfield, Conn.

### OPTIONS FRAUD: WHO DIDN'T SEE IT COMING?

IN “HOW THE OPTIONS mess got ugly—and expensive” (News & Insights, Sept. 11), David Henry notes that temptation to cheat when issuing options took over as their issuance soared. It is not quite clear that any compensation that allows such easy manipulation is proper *a priori* and needs regulations and controls from the start? How long does business fraud have to exist before we learn to shut the vault before the funds flow out? This isn’t rocket science.

—David H.  
Oakland, Calif.

### TECH EXECUTIVES SHOULD STAND ON THEIR OWN TWO FEET

RE “THE LBO GANG storms the Valley” (News & Insights, Sept. 11): Is the success call of a leveraged buyout attractive cause Silicon Valley executives are frustrated or simply ineffective at grappling with the dramatic changes of the post-dot-com era? Contrast the LBO takeovers with successful competitors (AMD, Apple, Cisco, Oracle), which are able to manage without falling back on executives such as a Wall Street that purportedly doesn’t understand them and the bu-

# Is your cholesterol out of whack?

Bad cholesterol high? Good cholesterol low? CRESTOR can help with both.

High blood pressure and diabetes are among factors that make it even more important to get your bad cholesterol low. But to get your cholesterol right, your doctor may also want your good cholesterol up. And diet and exercise alone may not be enough to lower the bad cholesterol and raise the good.

CRESTOR is a cholesterol medicine that does both.

A 10-mg dose of CRESTOR® (rosuvastatin calcium) along with diet can lower bad cholesterol, LDL, by up to 52% (vs 7% with placebo). CRESTOR can also raise good cholesterol, HDL, by up to 14% (vs 3% with placebo). Your results may vary.

Down with the bad  Up with the good 

Is CRESTOR right for you? That's a conversation you need to have with your doctor.

#### Important safety information about CRESTOR:

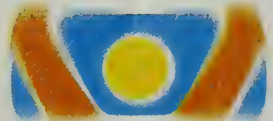
CRESTOR is prescribed along with diet for lowering high cholesterol and has not been determined to prevent heart disease, heart attacks, or strokes. CRESTOR is not right for everyone, including women who are nursing, pregnant, or who may become pregnant, or anyone with liver problems. Your doctor will do blood tests before and during treatment with CRESTOR to monitor your liver function. Unexplained muscle pain and weakness could be a sign of a rare but serious side effect and should be reported to your doctor right away. The 40-mg dose of CRESTOR is only for patients who do not reach goal on 20 mg. Be sure to tell your doctor if you are taking any medications. Side effects occur infrequently and include muscle aches, constipation, weakness, abdominal pain, and nausea. They are usually mild and tend to go away.

Please read the important Product Information about CRESTOR on the adjacent page.

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**BRIEF SUMMARY:** For full Prescribing Information, see package insert. **INDICATIONS AND USAGE:** CRESTOR is indicated: 1. as an adjunct to diet to reduce elevated total-C, LDL-C, ApoB, nonHDL-C, and TG levels and to increase HDL-C in patients with primary hypercholesterolemia (heterozygous familial and nonfamilial) and mixed dyslipidemia (Fredrickson Type IIa and IIb); 2. as an adjunct to diet for the treatment of patients with elevated serum TG levels (Fredrickson Type IV); 3. to reduce LDL-C, total-C, and ApoB in patients with homozygous familial hypercholesterolemia as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or if such treatments are unavailable. **CONTRAINDICATIONS:** CRESTOR is contraindicated in patients with a known hypersensitivity to any component of this product. Rosuvastatin is contraindicated in patients with active liver disease or with unexplained persistent elevations of serum transaminases (see WARNINGS, Liver Enzymes). **Pregnancy and Lactation:** Atherosclerosis is a chronic process and discontinuation of lipid-lowering drugs during pregnancy should have little impact on the outcome of long-term therapy of primary hypercholesterolemia. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they may cause fetal harm when administered to pregnant women. Therefore, HMG-CoA reductase inhibitors are contraindicated during pregnancy and in nursing mothers. **ROSUVASTATIN SHOULD BE ADMINISTERED TO WOMEN OF CHILDBEARING AGE ONLY WHEN SUCH PATIENTS ARE HIGHLY UNLIKELY TO CONCEIVE AND HAVE BEEN INFORMED OF THE POTENTIAL HAZARDS.** If the patient becomes pregnant while taking this drug, therapy should be discontinued immediately and the patient apprised of the potential hazard to the fetus. **WARNINGS:** **Liver Enzymes:** HMG-CoA reductase inhibitors, like some other lipid-lowering therapies, have been associated with biochemical abnormalities of liver function. The incidence of persistent elevations (>3 times the upper limit of normal [ULN]) occurring on 2 or more consecutive occasions in serum transaminases in fixed dose studies was 0.4, 0, 0, and 0.1% in patients who received rosuvastatin 5, 10, 20, and 40 mg, respectively. In most cases, the elevations were transient and resolved or improved on continued therapy or after a brief interruption in therapy. There were two cases of jaundice, for which a relationship to rosuvastatin therapy could not be determined, which resolved after discontinuation of therapy. There were no cases of liver failure or irreversible liver disease in these trials. **It is recommended that liver function tests be performed before and at 12 weeks following both the initiation of therapy and any elevation of dose, and periodically (e.g., semiannually) thereafter.** Liver enzyme changes generally occur in the first 3 months of treatment with rosuvastatin. Patients who develop increased transaminase levels should be monitored until the abnormalities have resolved. Should an increase in ALT or AST of >3 times ULN persist, reduction of dose or withdrawal of rosuvastatin is recommended. Rosuvastatin should be used with caution in patients who consume substantial quantities of alcohol and/or have a history of liver disease (see CLINICAL PHARMACOLOGY, Special Populations, Hepatic Insufficiency). Active liver disease or unexplained persistent transaminase elevations are contraindications to the use of rosuvastatin (see CONTRAINDICATIONS). **Myopathy/Rhabdomyolysis:** Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with rosuvastatin and with other drugs in this class. Uncomplicated myalgia has been reported in rosuvastatin-treated patients (see ADVERSE REACTIONS). Creatine kinase (CK) elevations (>10 times upper limit of normal) occurred in 0.2% to 0.4% of patients taking rosuvastatin at doses up to 40 mg in clinical studies. Treatment-related myopathy, defined as muscle aches or muscle weakness in conjunction with increases in CK values >10 times upper limit of normal, was reported in up to 0.1% of patients taking rosuvastatin doses of up to 40 mg in clinical studies. In clinical trials, the incidence of myopathy and rhabdomyolysis increased at doses of rosuvastatin above the recommended dosage range (5 to 40 mg). In postmarketing experience, effects on skeletal muscle, e.g., uncomplicated myalgia, myopathy, and rarely, rhabdomyolysis have been reported in patients treated with HMG-CoA reductase inhibitors including rosuvastatin. As with other HMG-CoA reductase inhibitors, reports of rhabdomyolysis with rosuvastatin are rare, but higher at the highest marketed dose (40 mg). Factors that may predispose patients to myopathy with HMG-CoA reductase inhibitors include advanced age (>65 years), hypothyroidism, and renal insufficiency. Consequently: 1. Rosuvastatin should be prescribed with caution in patients with predisposing factors for myopathy, such as, renal impairment (see DOSAGE AND ADMINISTRATION), advanced age, and inadequately treated hypothyroidism. 2. Patients should be advised to promptly report unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. Rosuvastatin therapy should be discontinued if markedly elevated CK levels occur or myopathy is diagnosed or suspected. 3. The 40 mg dose of rosuvastatin is reserved only for those patients who have not achieved their LDL-C goal utilizing the 20 mg dose of rosuvastatin once daily (see DOSAGE AND ADMINISTRATION). 4. The risk of myopathy during treatment with rosuvastatin may be increased with concurrent administration of other lipid-lowering therapies or cyclosporine. (see CLINICAL PHARMACOLOGY, Drug Interactions, PRECAUTIONS, Drug Interactions, and DOSAGE AND ADMINISTRATION). The benefit of further alterations in lipid levels by the combined use of rosuvastatin with fibrates or niacin should be carefully weighed against the potential risks of this combination. Combination therapy with rosuvastatin and gemfibrozil should generally be avoided. (see DOSAGE AND ADMINISTRATION and PRECAUTIONS, Drug Interactions). 5. The risk of myopathy during treatment with rosuvastatin may be increased in circumstances which increase rosuvastatin drug levels (see CLINICAL PHARMACOLOGY, Special Populations, Race and Renal Insufficiency, and PRECAUTIONS, General). 6. Rosuvastatin therapy should also be temporarily withheld in any patient with an acute, serious condition suggestive of myopathy or predisposing to the development of renal failure secondary to rhabdomyolysis (e.g., sepsis, hypotension, dehydration, major surgery, trauma, severe metabolic, endocrine, and electrolyte disorders, or uncontrolled seizures). **PRECAUTIONS:** **General:** Before instituting therapy with rosuvastatin, an attempt should be made to control hypercholesterolemia with appropriate diet and exercise, weight reduction in obese patients, and treatment of underlying medical problems (see INDICATIONS AND USAGE). Administration of rosuvastatin 20 mg to patients with severe renal impairment ( $Cl_{CR} < 30$  mL/min/1.73 m<sup>2</sup>) resulted in a 3-fold increase in plasma concentrations of rosuvastatin compared with healthy volunteers (see WARNINGS, Myopathy/Rhabdomyolysis and DOSAGE AND ADMINISTRATION). The result of a large pharmacokinetic study conducted in the US demonstrated an approximate 2-fold elevation in median exposure in Asian subjects (having either Filipino, Chinese, Japanese, Korean, Vietnamese or Asian-Indian origin) compared with a Caucasian control group. This increase should be considered when making rosuvastatin dosing decisions for Asian patients. (See WARNINGS, Myopathy/Rhabdomyolysis, CLINICAL PHARMACOLOGY, Special Populations, Race, and DOSAGE AND ADMINISTRATION.) **Information for Patients:** Patients should be advised to report promptly unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. When taking rosuvastatin with an aluminum and magnesium hydroxide combination antacid, the antacid should be taken at least 2 hours after rosuvastatin administration (see CLINICAL PHARMACOLOGY, Drug Interactions). **Laboratory Tests:** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg, when compared to lower doses of rosuvastatin or comparator studies, though it was generally transient and was not associated with worsening renal function. Although the clinical significance of this finding is unknown, a dose reduction should be considered for patients on rosuvastatin 40 mg therapy with unexplained persistent proteinuria during routine urinalysis testing. **Drug Interactions:** **Cyclosporine:** When rosuvastatin 10 mg was coadministered with cyclosporine in cardiac transplant patients, rosuvastatin mean  $C_{max}$  and mean AUC were increased 11-fold and 7-fold, respectively, compared with healthy volunteers. These increases are considered to be clinically significant and require special consideration in the dosing of rosuvastatin to patients taking concomitant cyclosporine (see WARNINGS, Myopathy/Rhabdomyolysis,

and DOSAGE AND ADMINISTRATION). **Warfarin:** Coadministration of rosuvastatin to patients on stable warfarin therapy resulted in clinically significant rises in INR (>4, baseline 2-3). In patients taking coumatin anticoagulants and rosuvastatin concomitantly, INR should be determined before starting rosuvastatin and frequently enough during early therapy to ensure that no significant alteration of INR occurs. Once a stable INR has been documented, INR can be monitored at the intervals usually recommended for patients on coumatin anticoagulants. If the dose of rosuvastatin is changed, the same procedure should be repeated. Rosuvastatin therapy has not been associated with bleeding or with changes in INR in patients not taking anticoagulants. **Gemfibrozil:** Coadministration of a single rosuvastatin dose to healthy volunteers on gemfibrozil (600 mg twice daily) resulted in a 2.2- and 1.9-fold, respectively, increase in mean  $C_{max}$  and mean AUC of rosuvastatin (see DOSAGE AND ADMINISTRATION). **Endocrine Function:** Although clinical studies have shown that rosuvastatin alone does not reduce basal plasma cortisol concentration or impair adrenal reserve, caution should be exercised if any HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered concomitantly with drugs that may decrease the levels or activity of endogenous steroid hormones such as ketoconazole, spironolactone, and cimetidine. **CNS Toxicity:** CNS vascular lesions, characterized by perivascular hemorrhages, edema, and mononuclear cell infiltration of perivascular spaces, have been observed in dogs treated with several other members of this drug class. A chemically similar drug in this class produced dose-dependent optic nerve degeneration (Wallenrod degeneration of retinogeniculate fibers) in dogs, at a dose that produced plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose. Edema, hemorrhage, and partial necrosis in the interstitium of the choroid plexus was observed in a female dog sacrificed moribund at day 24 at 30 mg/kg/day by oral gavage (systemic exposures 100 times the human exposure at 40 mg/day based on AUC comparisons). Corneal opacity was seen in dogs treated for 52 weeks at 40 mg/kg/day by oral gavage (systemic exposures 20 times the human exposure at 40 mg/day based on AUC comparisons). Cataracts were seen in dogs treated for 12 weeks by oral gavage at 40 mg/kg/day (systemic exposures 60 times the human exposure at 40 mg/day based on AUC comparisons). Retinal dysplasia and retinal loss were seen in dogs treated for 4 weeks by oral gavage at 90 mg/kg/day (systemic exposures 100 times the human exposure at 40 mg/day based on AUC). Doses  $\leq 30$  mg/kg/day (systemic exposures  $\leq 60$  times the human exposure at 40 mg/day based on AUC comparisons) following treatment up to one year, did not reveal retinal findings. **Carcinogenesis, Mutagenesis, Impairment of Fertility:** In a 104-week carcinogenicity study in rats at dose levels of 2, 20, 60, or 80 mg/kg/day by oral gavage, the incidence of uterine stromal polyps was significantly increased in females at

patients in placebo-controlled clinical studies of rosuvastatin are shown in Table 1; dissections due to adverse events in these studies of up to 12 weeks duration occurred in 3% of patients on rosuvastatin and 5% on placebo.

Table 1. Adverse Events in Placebo-Controlled Studies

| Adverse event           | Rosuvastatin<br>N=744 | Placebo<br>N=392 |
|-------------------------|-----------------------|------------------|
| Pharyngitis             | 9.0                   | 7.6              |
| Headache                | 5.5                   | 5.0              |
| Diarrhea                | 3.4                   | 2.9              |
| Dyspepsia               | 3.4                   | 3.1              |
| Nausea                  | 3.4                   | 3.1              |
| Myalgia                 | 2.8                   | 1.3              |
| Asthenia                | 2.7                   | 2.6              |
| Back pain               | 2.6                   | 2.4              |
| Flu syndrome            | 2.3                   | 1.8              |
| Urinary tract infection | 2.3                   | 1.6              |
| Rhinitis                | 2.2                   | 2.1              |
| Sinusitis               | 2.0                   | 1.8              |

In addition, the following adverse events were reported, regardless of causality assessment  $\geq 1\%$  of 10,275 patients treated with rosuvastatin in clinical studies. The events in *italics* are  $\geq 2\%$  in these patients. **Body as a Whole:** Abdominal pain, accidental injury, chest pain, pain, pelvic pain, and neck pain. **Cardiovascular System:** Hypertension, angina pectoris, vasodilation, and palpitation. **Digestive System:** Constipation, gastroenteritis, vomiting, indigestion, and gastritis. **Endocrine:** Diabetes mellitus, Hemiparesis, and Lymph System: Anemia and ecchymosis. **Metabolic and Nutritional Disorders:** Peripheral Neuropathy, hypokalemia, hypomagnesemia, depression, anxiety, vertigo, and Dizziness. **Respiratory System:** Arthritis, arthralgia, and pathological fracture. **Nervous System:** Insomnia, hyperkalemia, parosmia, depression, anxiety, vertigo, and Asthma. **Respiratory System:** Bronchitis, cough increased, dyspnea, pneumonia, and asthma. **Respiratory System:** Rash and pruritus. **Laboratory Abnormalities:** In the rosuvastatin clinical program, dipstick-positive proteinuria and microscopic hematuria were observed among statin-treated patients, predominantly in patients dosed above the recommended dose range (80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg compared to lower doses of rosuvastatin or comparator studies, though it was generally transient and was not associated with worsening renal function. (see PRECAUTIONS, Laboratory Abnormalities). Other abnormal laboratory values reported were elevated creatine phosphokinase, lactate dehydrogenase, hyperkalemia, glutamyl transpeptidase, alkaline phosphatase, bilirubin, and function abnormalities. Other adverse events reported less frequently than 1% in the rosuvastatin clinical study program, regardless of causality assessment, included arrhythmia, hepatitis, sensitivity reactions (i.e., face edema, thrombocytopenia, leukopenia, vesiculobullous urticaria, and angioedema), kidney failure, syncope, myasthenia, myositis, pancreatitis, pharyngitis, myopathy, and rhabdomyolysis. **Postmarketing Experience:** In addition to the events reported above, and with other drugs in this class, the following event is reported during post-marketing experience with CRESTOR, regardless of causality assessment: very rare cases of jaundice. **OVERDOSE:** There is no specific treatment in the event of overdose. In the event of overdose, the patient should be treated symptomatically and supportive measures instituted as required. Hemodialysis does not significantly enhance clearance of statin. **DOSAGE AND ADMINISTRATION:** The patient should be placed on a cholesterol-lowering diet before receiving CRESTOR and should continue on this diet during treatment. CRESTOR can be administered as a single dose at any time of day, with or without food. **Hypercholesterolemia (Heterozygous Familial and Nonfamilial):** Initial dosing for patients with hypercholesterolemia should be individualized according to therapy and response. The usual recommended starting dose of CRESTOR is 10 mg on day 1. However, initiation of therapy with 5 mg once daily should be considered for patients requiring aggressive LDL-C reductions, who have predisposing factors for myopathy, and as noted in special populations such as patients taking cyclosporine, Asian patients, and patients with renal insufficiency (see CLINICAL PHARMACOLOGY, Race, and Renal Insufficiency, and Interactions). For patients with marked hypercholesterolemia (LDL-C >190 mg/dL) and/or lipid targets, a 20-mg starting dose may be considered. After initiation and/or upon titration, lipid levels should be re-evaluated within 2 to 4 weeks and dosage adjusted accordingly. The 40-mg dose of CRESTOR is reserved only for those patients who have not achieved LDL-C goal utilizing the 20 mg dose of CRESTOR once daily (see WARNINGS, Myopathy/Rhabdomyolysis). When initiating statin therapy or switching from another statin to appropriate CRESTOR starting dose should first be utilized, and only then titrated according to the patient's individualized goal of therapy. **Homozygous Familial Hypercholesterolemia:** The recommended starting dose of CRESTOR is 20 mg once daily in patients with homozygous FH. The maximum recommended daily dose is 40 mg CRESTOR in these patients as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or treatments are unavailable. Response to therapy should be estimated from pre-apheresis levels. **Dosage in Asian Patients:** Initiation of CRESTOR therapy with 5 mg once daily should be considered for Asian patients. The potential for increased systemic exposures in Caucasians is relevant when considering escalation of dose in cases where hypercholesterolemia is not adequately controlled at doses of 5, 10, or 20 mg once daily. (See WARNINGS, Myopathy/Rhabdomyolysis, CLINICAL PHARMACOLOGY, Special Populations, Race, and PRECAUTIONS, General). **Dosage in Patients Taking Cyclosporine:** In patients taking cyclosporine, therapy should be limited to CRESTOR 5 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Concomitant Lowering Therapy:** The effect of CRESTOR on LDL-C and total-C may be enhanced in combination with a bile acid binding resin. If CRESTOR is used in combination with gemfibrozil, the dose of CRESTOR should be limited to 10 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Dosage in Patients With Renal Insufficiency:** No modification of dosage is necessary for patients with moderate renal insufficiency. For patients with severe renal impairment ( $Cl_{CR} < 30$  mL/min/1.73 m<sup>2</sup>) not on hemodialysis, dosing of CRESTOR should be started at 5 mg once daily and increased to 10 mg once daily (see PRECAUTIONS, General, and CLINICAL PHARMACOLOGY, Special Populations, Renal Insufficiency).

**NOTE:** This summary provides important information about CRESTOR. For more information, please ask your doctor or health care professional about the full Prescribing Information. Discuss it with them.

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80 mg/kg/day at systemic exposure 20 times the human exposure at 40 mg/day based on AUC. Increased incidence of polyps was not seen at lower doses. In a 107-week carcinogenicity study in mice given 10, 60, 200 mg/kg/day by oral gavage, an increased incidence of hepatocellular adenoma/carcinoma was observed at 200 mg/kg/day at systemic exposures 20 times human exposure at 40 mg/day based on AUC. An increased incidence of hepatocellular tumors was not seen at lower doses. Rosuvastatin was not mutagenic or clastogenic with or without metabolic activation in the Ames test with *Salmonella typhimurium* and *Escherichia coli*, the mouse lymphoma assay, and the chromosomal aberration assay in Chinese hamster lung cells. Rosuvastatin was negative in the *in vivo* mouse micronucleus test. In rat fertility studies with oral gavage doses of 5, 15, 50 mg/kg/day, males were treated for 9 weeks prior to and throughout mating and females were treated 2 weeks prior to mating and throughout mating until gestation day 7. No adverse effect on fertility was observed at 50 mg/kg/day (systemic exposures up to 10 times human exposure at 40 mg/day based on AUC comparisons). In testicles of dogs treated with rosuvastatin at 40 mg/kg/day for one month, spermatid giant cells were seen. Spermatid giant cells were observed in monkeys after 6-month treatment at 30 mg/kg/day in addition to vacuolation of seminiferous tubular epithelium. Exposures in the dog were 20 times and in the monkey 10 times human exposure at 40 mg/day based on body surface area comparisons. Similar findings have been seen with other drugs in this class. **Pregnancy:** **Pregnancy Category X** See CONTRAINDICATIONS. Rosuvastatin may cause fetal harm when administered to a pregnant woman. Rosuvastatin is contraindicated in women who are or may become pregnant. Safety in pregnant women has not been established. There are no adequate and well-controlled studies of rosuvastatin in pregnant women. Rosuvastatin crosses the placenta and is found in fetal tissue and amniotic fluid at 3% and 20%, respectively, of the maternal plasma concentration following a single 25 mg/kg oral gavage dose on gestation day 16 in rats. A higher fetal tissue distribution (25% maternal plasma concentration) was observed in rabbits after a single oral gavage dose of 1 mg/kg on gestation day 18. If this drug is administered to a woman with reproductive potential, the patient should be apprised of the potential hazard to a fetus. In female rats given oral gavage doses of 5, 15, 50 mg/kg/day rosuvastatin before mating and continuing through day 7 postcoitus resulted in decreased fetal body weight (female pups) and delayed ossification at the high dose (systemic exposures 10 times human exposure at 40 mg/day based on AUC comparisons). In pregnant rats given oral gavage doses of 2, 20, 50 mg/kg/day from gestation day 7 through lactation day 21 (weaning), decreased pup survival occurred in groups given 50 mg/kg/day, systemic exposures  $\geq 12$  times human exposure at 40 mg/day based on body surface area comparisons. In pregnant rabbits given oral gavage doses of 0.3, 1, 3 mg/kg/day from gestation day 6 to lactation day 18 (weaning), exposures equivalent to human exposure at 40 mg/day based on body surface area comparisons, decreased fetal viability and maternal mortality was observed. Rosuvastatin was not teratogenic in rats at  $\leq 25$  mg/kg/day or in rabbits  $\leq 3$  mg/kg/day (systemic exposures equivalent to human exposure at 40 mg/day based on AUC or body surface comparison, respectively). **Nursing Mothers:** It is not known whether rosuvastatin is excreted in human milk. Studies in lactating rats have demonstrated that rosuvastatin is secreted into breast milk at levels 3 times higher than that obtained in the plasma following oral gavage dosing. Because many drugs are excreted in human milk and because of the potential for serious adverse reactions in nursing infants from rosuvastatin, a decision should be made whether to discontinue nursing or administration of rosuvastatin taking into account the importance of the drug to the lactating woman. **Pediatric Use:** The safety and effectiveness in pediatric patients have not been established. Treatment experience with rosuvastatin in a pediatric population is limited to 8 patients with homozygous FH. None of these patients was below 8 years of age. **Geriatric Use:** Of the 10,275 patients in clinical studies with rosuvastatin, 3,159 (31%) were 65 years and older, and 698 (6.8%) were 75 years and older. The overall frequency of adverse events and types of adverse events were similar in patients above and below 65 years of age. (See WARNINGS, Myopathy/Rhabdomyolysis.) The efficacy of rosuvastatin in the geriatric population ( $\geq 65$  years of age) was comparable to the efficacy observed in the non-elderly. **ADVERSE REACTIONS:** Rosuvastatin is generally well tolerated. Adverse reactions have usually been mild and transient. In clinical studies of 10,275 patients, 3.7% were discontinued due to adverse experiences attributable to rosuvastatin. The most frequent adverse events thought to be related to rosuvastatin were myalgia, constipation, asthenia, abdominal pain, and nausea. **Clinical Adverse Experiences:** Adverse experiences, regardless of causality assessment, reported in  $\geq 2\%$  of



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# ReadersReport

of the Sarbanes-Oxley Act, among others.

Struggling tech executives are compensated very well to manage these elements while working on the long term. If they and their board members had a higher degree of accountability, they would implement the tough strategic and operational actions that typically result from an LBO while still public. Instead, the "it's not our fault" hand-wringing continues. Then an LBO calls, shareholders (the owners, after all) make a small gain (if any), and the executives, who failed to deliver in the first place, are rewarded handsomely. Go figure.

—Michael O'Keeffe  
Boulder, Colo.

## IN THE EAST OR THE WEST, BIG BROTHER REQUIRES HARDWARE

"HELPING BIG BROTHER go high tech" (Special Report, Sept. 18) is very timely and informative. In the name of maintaining social stability, the Chinese government is devoting exorbitant resources and employing both high- and low-tech methods to control the population. However, with far more advanced technologies ready at hand, a government in the West can potentially operate a far more

**“Guess who it helps if Cisco or Oracle are forced to stop selling... in China.”**

—Kim Lathrop  
Portland, Ore.

effective and discreet surveillance program in the name of fighting terrorism and protecting the nation. I shudder at the thought of that (hopefully unlikely) scenario.

—Gang Guo  
Croft Assistant Professor,  
Political Science & International Studies  
University of Mississippi  
Oxford, Miss.

IT TAKES ABOUT your first 15 minutes in any of China's major cities to realize that China has arrived. Politically motivated restrictions by the U.S. government in most technological areas are a quaint nod to a time when the U.S. might have



had some influence. So guess who helps if Cisco Systems Inc. or Oracle Corp. are forced to stop selling security products in China: their international competitors, or indeed, Chinese firms. Now, guess who it hurts: Cisco or Oracle shareholders. U.S. restrictions are value-neutral to China's political interests or spiritual cults.

—Kim Lathrop  
Portland

I FIND CISCO'S China President The Lam's statement, "It is our users, not Cisco, that determine the applications to be deployed," to be transparent and disingenuous. Given such an amoral position,

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od thing Cisco is not in the centrifuge  
business!

—Eric Braun  
Scotts Valley, Calif.

## CREDIT FOR A GREEN BUILDING WHERE CREDIT IS DUE

"THE GREEN STAMP of approval"  
environment, Sept. 11), I think it's impor-  
tant to point out that the Genzyme Center  
is designed by Behnisch Architects.

—Julie D. Taylor, Principal  
Taylor & Company  
Los Angeles

## THE NEW SAFEWAY, BETTER OR FOR WORSE

SAFEWAY HAS BEEN working very hard  
to improve the quality of the perishables  
it sells and has invested substantially in  
improving the shopping environment in  
its stores through an accelerated remodel-  
ing program. Justin Hibbard noted these  
changes in "Put your money where your  
mouth is" (Design, Sept. 18). We would  
like to clarify that the design and imple-  
mentation of our Lifestyle stores has been  
carried out by an internal group of very  
capable, hard-working Safeway employ-  
ees with input from retail, marketing, de-

sign, construction, and executive man-  
agement. While Orangetwice (then  
Avizia) assisted us in an advisory role  
with ideas and concepts early in the  
process, the basis for our transformation  
was clearly internally driven.

—Brian G. Dowling  
Vice-President, Public Affairs  
Safeway Inc.  
Pleasanton, Calif.

WHILE SAFEWAY has made some  
changes for the better with store  
makeovers, our McLean (Va.) store has  
seen a dramatic plunge in the quality of  
customer service and in inventory con-  
trols. The aftermath of a new labor con-  
tract led to an exit of some great people  
and an arrival of a new generation, which  
appears to be poorly trained and has a  
bad attitude on top of it. Shelves are often  
empty and products are in disarray.

—Andrei Quinn-Barabanov  
McLean, Va.

LONGTIME GROCERY shoppers in Chi-  
cagoland got a taste of how Safeway  
ruined Dominick's Finer Foods when they  
acquired this quality food retailer. Within a  
short time, Safeway dramatically raised

prices, popular local brands were no  
longer on the shelves, and some produce  
items were so bad that I would not have  
placed them in my cart, even if they were  
free. I used to love shopping at Dominick's.  
Unless Safeway's compelling "authentic  
market story" quickly and actually delivers  
the promise of improvement, my food dol-  
lars will go to Whole Foods and Costco.

—James Lentz  
Wheaton, Ill.

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| <b>New Era Fund<sup>2</sup> (PRNEX)</b><br><i>Invests primarily in natural resource companies.</i>                                             | <b>33.59%</b> | <b>18.52%</b> | <b>14.16%</b> |
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# A Smarter Math Machine

After 17 years of arguing that calculators had made many computational skills obsolete, the National Council of Teachers of Mathematics now says it's important that kids master long division and adding fractions. This is a long-overdue development. But I hope that in the reaction against the abuse of technology, teachers don't expel the calculators.

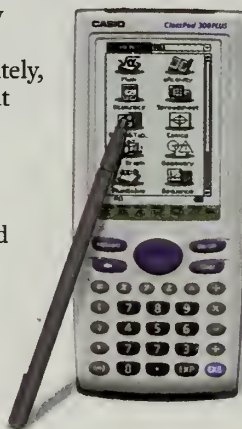
Children today start to use these devices in primary school, and by the time they enter high school math classes the gadgets are indispensable. Used appropriately, advanced calculators can take a lot of the drudgery out of math, and their graphic abilities can help students visualize relationships that are an important part of algebra and calculus.

Often, though, calculator-based activities become exercises in meaningless button-pushing. I have heard far too many tales of high school and even university students who whip out their calculators to do simple addition or who are flummoxed when asked to add fractions—sure signs of inadequate basic math skills.

The Casio ClassPad 300 Plus strikes me as a tool that offers all of the advantages of a graphing machine while also encouraging the development of mathematical understanding rather than calculator technique. Priced at \$150, it's just about at the mid-range for graphing calculators from Texas Instruments, the overwhelming market leader. But the ClassPad boasts many functions previously available only on computers with special software—and bests many of those offerings in ease of use.

**AT FIRST GLANCE, THE CLASSPAD** looks like an overgrown version of a cheap pocket calculator, since it lacks the dozens of multifunction buttons that are TI's hallmark. In place of those keys, it features a 16-line, 20-character display, more than twice the size of the screen on the widely used TI-84 Plus. Equally important, the screen is touch-sensitive. This makes it possible to replace the cryptic notations found on calculator keys with much more descriptive on-screen menu items that can be selected with a stylus or, if you're careful, the tip of a finger.

The biggest advantage of the touch screen is that it lets the ClassPad behave more like a computer while retaining the low cost and convenience of a calculator. Like TI's top-of-the-line TI-89, the ClassPad has an algebra system that lets it manipulate both numbers and expressions that include variables. These can be tedious to enter on either device. Unlike TI's model, however, Casio's lets you reuse an expression just by selecting it with the stylus and either copying and pasting it or dragging it to a new location,



**Casio's  
ClassPad  
helps  
students  
grasp  
advanced  
concepts**

just as you would in Microsoft Word.

That's a time-saver, but it barely hints at the range of things the ClassPad can do. If you enter an equation and drag it into a geometry area on the screen, the calculator will draw its graph. Even better, if you draw a curve and drag the image to an algebra area, you will get its equation. This allows interesting explorations of the important relationships between algebra and geometry. For geometry, you can use the stylus and drawing tools to create all of the classic compass and straightedge constructions and change shapes simply by dragging points. The one thing it

would make the geometry tools better would be a color display. But the high power demand would require a rechargeable battery, pushing price toward \$200.

For all the ClassPad's virtues, I don't expect to see it turning up in large numbers at schools. After years of cultivating teachers, school boards, and textbook publishers, TI has won more than a 90% market share for calculators and has an entire curriculum built around some models. Casio hasn't committed the marketing resources needed to make a dent in TI's dominance.

But if you have a child who needs help grasping advanced math concepts, or one who might benefit from some in-depth exploration of mathematical relationships, the ClassPad Plus could be \$150 well spent. It's the best sort of educational technology: a tool that can deepen understanding. ■

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## No Slick Way Out for Tribune

**At what point does it become easier** for Tribune Co. to give up and just unload the *Los Angeles Times*? Given that the Tribune is getting a battering for its management—more on that later—and that potential buyers exist, asked one analyst, well, why not? The droll, BlackBerry'd reply: "Sets a bad precedent, as they could then lose every paper."

The *Times* is one of America's great newspapers and also one of its oddest. Flush with ads and pride in generous times, the paper has made two aborted lunges in the past decade toward national expansion and East Coast editions. Changing times chasten ambitions, but the *Times* remains a paper for which no familiar model fits. Is it a purely local paper? The 2000 Census tallied more than 9.5 million people within sprawling Los Angeles County alone, so the least ambitious definition of the *Times* encompasses a population greater than any of the 50 states but eight. In practical terms, this means standard guesstimates of, say, how many reporters are needed at a paper of its circulation may not apply. In philosophical terms, it means the *Times* is the only major American daily to have ping-ponged among national, local, and regional identities without comfortably landing on any.

**IN THE BEST OF TIMES**, TRIBUNE likely would not bother much with such concerns. These are not the best of times. The board is mulling asset sales. The *Times*' revenues and profits are slipping. The situation is so delicate that I should mention editor Dean Baquet and publisher Jeff Johnson, who balked at corporate demands for more cutbacks, remained in their jobs at press time. (It's inexact to equate head count with quality, since 10 sharp reporters do more than 30 lousy ones, but the *Times* has cut more than 20% of 1,200 newsroom staffers since Tribune bought parent Times Mirror in 2000. At what point does it max out on cuts?) Those who slammed Knight Ridder for prizing profit over quality now whack Tribune. As might be expected in a town awash in cash and ego, local billionaires such as David Geffen have expressed interest in buying the paper. (Tribune CEO Dennis FitzSimons has said the *Times* is not for sale, but it's no longer his decision.) A new owner would thrill *Times* partisans and relieve Tribune types weary of being fitted with black hats. A shame, then, that such an outcome is so unlikely.

Life for Tribune would be easier without it. Four



**Tribune Co. may find it's cheaper to keep the troubled L.A. Times than sell it**

leave Tribune with a massive tax bill that could top 40% of proceeds. (Tribune and *Times* executives would not comment.)

That point resonates with Wall Street types, even if the *Times*' own struggle doesn't. Smart money says Tribune will divest its 26 TV stations and perhaps some smaller newspapers, borrow big, swallow hard, and go private. Which leaves Tribune and the *Los Angeles Times* in an unhappy marriage, one that shows no sign of reconciliation, reinvention, or end. ■

newspaper companies just lowered this quarter forecasts, among them The New York Times Co., in part because of weaker revenues at big-city papers. "Metro dailies are losing revenues much faster than any other class of print," says a top newspaper executive. "I am not sure you can chase that revenue decline with expense cuts fast enough to maintain profitability." Meanwhile, Baquet and Johnson's efforts to hold the line are not appreciated on Wall Street. "You've got the socialists trying to run the place," cracks one analyst.

But I'm hard pressed to think of any socialist enterprise with 20% profit margins, which the *Los Angeles Times* notched in the past few years on revenues topping \$1.1 billion. (This year is tough, hence the standoff.) Its rough profit was about 20% of Tribune's total Standard multiples for newspaper deals, inasmuch as they still suggest a sale price exceeding \$2.6 billion, an eye-popping sum even for the David Geffens of the world. But set aside the price.

Analysts say a *Times* sale would

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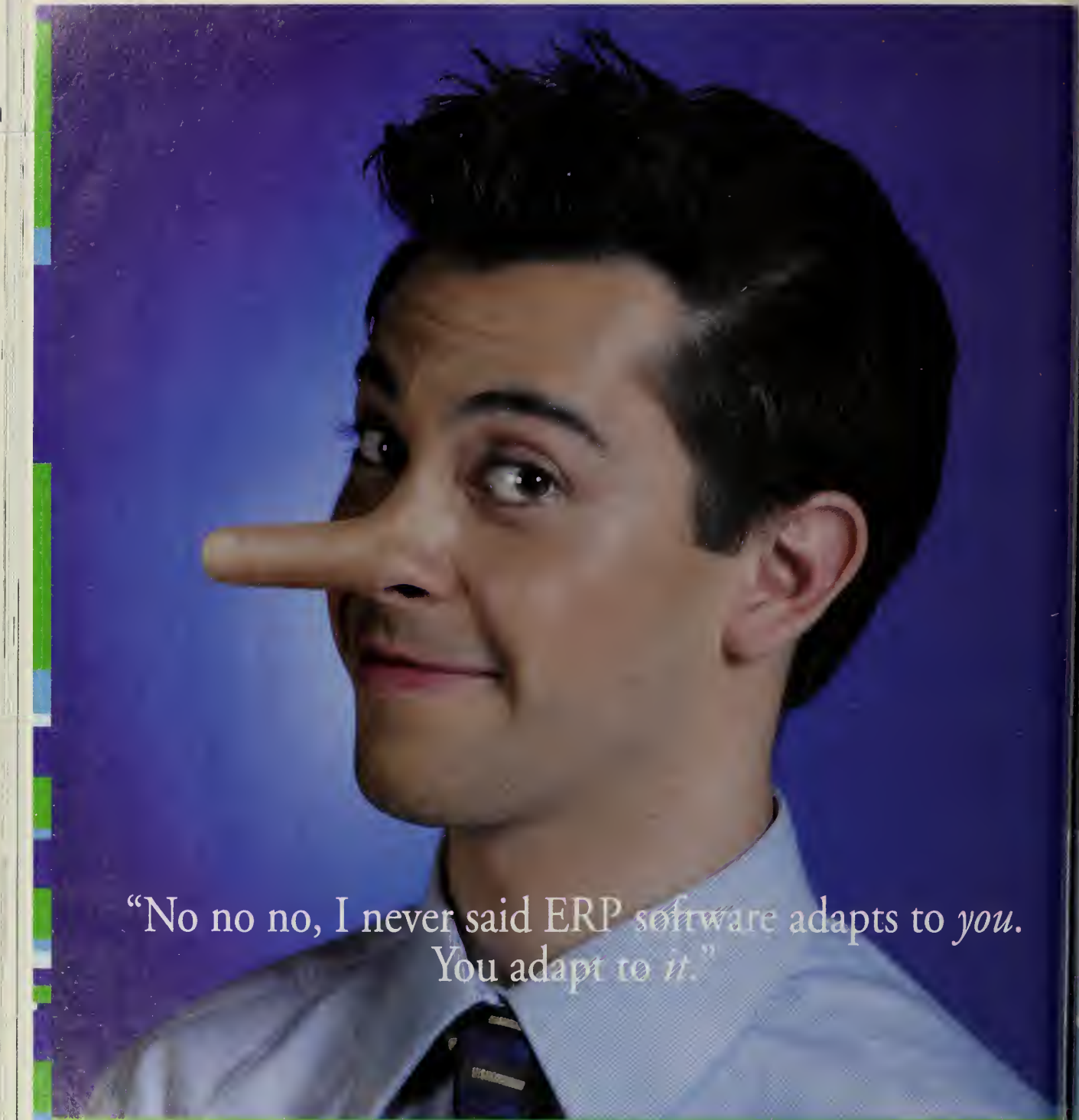


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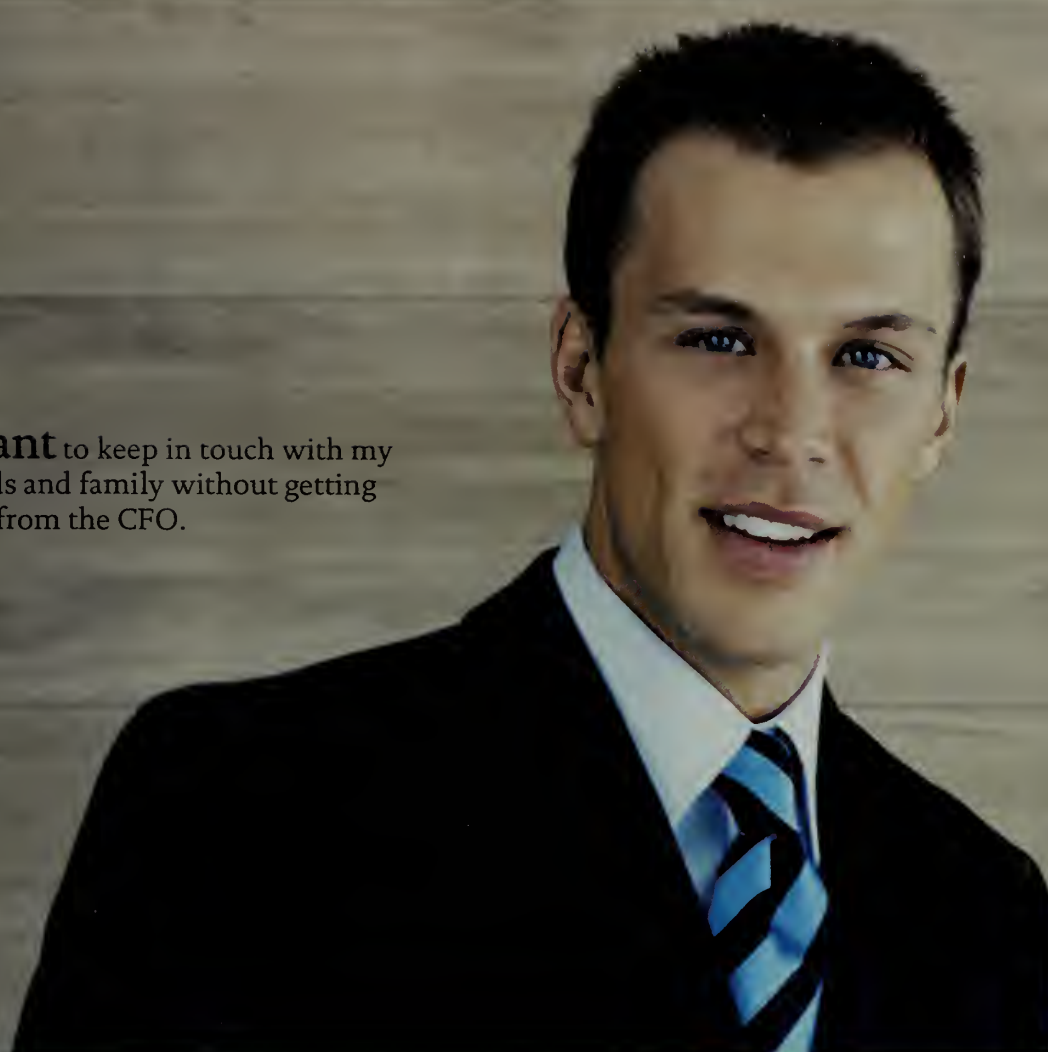
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JAMES C. COOPER

# Consumers Aren't Sweating The Housing Slump Yet

They're coping, thanks to solid household finances and cheaper energy

**U.S. ECONOMY** The debate over the direction of the economy and Federal Reserve policy in the coming year boils down to one basic question: Will the housing slump drag down consumer spending and the economy? As you ponder your position on that issue, keep in mind that throughout this nearly five-year expansion, one bet has been

consistently bad: the one against American consumers. For their part, a few big-time bond market folks think a housing-led decline will reduce the economic growth rate to a paltry 1%-2% range in the second half and the Fed will cut interest rates. Energized recently by some weak economic reports on housing and the industrial sector, several key players have been buying bonds like mad, pushing yields down to six-month lows. Analysts on the other side of the argument believe the reports under the consumer sector are strong enough to withstand the burdens that weaker home buying, construction activity, and home prices will place on household spending. If consumers hold up, then so will total spending by businesses, and the strong global economy will continue to fuel U.S. exports. So who's right? Will the bond mavens cash in big, or will resilient consumers buoy the economy and force the bond investors to dump those giant positions?

**NOW, CONSUMERS** still have the winning hand. Though job gains have slowed, labor markets remain strong, and they are generating income at a rapid clip. Personal income in the third quarter is on track to grow at 7.5% from the previous year, a good deal faster than in 2005. Also, consumer finances remain in good shape, with further additions to household net worth in the third quarter. Mortgage delinquency rates at banks, which rose up slightly from the year before, remain low, as do payments for consumer loans and retail credit cards. In addition, as gasoline and heating oil prices plummet, consumers are getting an enormous purchasing power windfall that is already boosting confidence, and it will lift spending in coming months. Finally, bond players themselves are helping to stabilize the housing market, as mortgage rates have followed short-term rates down. Since June 23, 30-year fixed rates have fallen from 6.86% to 6.18% (chart). In August sales of new single-family homes stopped declining, and the number of new homes actually rose.

The recent signs of weakness in the economy are showing up in places other than consumer spending. Most notably, activity in the industrial sector cooled this summer. That is clear from the downtick in August

industrial production, a second straight monthly dip in durable goods orders in August, and at least one puny-looking regional survey of factory activity in September from the Philadelphia Federal Reserve district.

This production lull appears to be an inventory adjustment that should quickly run its course.

Inventories appear to be growing a bit faster than

businesses would like, although much of the imbalance is concentrated in the auto industry, where carmakers have cut output sharply in the third quarter.

The auto-led adjustment, along with the downdraft from housing, will have a negative impact on third-quarter economic growth,

as measured by real gross domestic product. And the sharp drop in housing starts from June to August means the homebuilding slump could directly subtract up to a full percentage point from the quarter's GDP growth.

**BUT THIS QUARTER'S** overall GDP rate, to be reported in late October, will not tell you much about the future. For that, you have to look at what's happening in the key spending categories, in particular, outlays by consumers and businesses. So far through the quarter, demand in both sectors looks solid. Consumer outlays are on a growth path that is even faster than the pace in the second quarter, and the same is true for capital spending. Through August, orders and shipment of capital goods are far above their second-quarter averages. Plus, the full benefit of lower energy prices will add support to fourth-quarter demand.

Households are already feeling better about their prospects. The Conference Board's index of consumer confidence rose in September, to 104.5 from 100.2 in August, and this optimism should continue into October. Consumers' expectations for conditions over the next six

## SOME SUPPORT FOR HOUSING





months were the highest since April, and households were marginally more upbeat about jobs than they were in August. Not surprisingly, weekly retail reports so far in September suggest solid sales activity compared with the year before. If consumers have big concerns about the housing sector's weakness, they aren't showing it.

**PERHAPS THE BIGGEST QUESTION** in the consumer outlook, and one economists are sharply divided on, is the indirect impacts of the housing slump, specifically the waning amount of money homeowners are able to withdraw from the equity in their homes as home values level off. One camp believes equity withdrawal has been a big boost to spending, and as it ebbs, consumers will have to cut back substantially. The other group thinks the issue is a red herring, and that the more important factor for spending is overall household wealth.

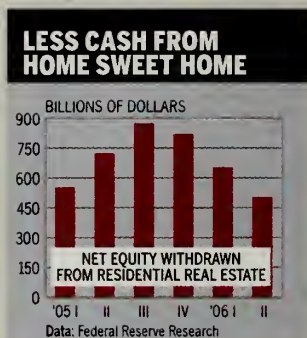
So far, the resilience in consumer spending lines up better with the wealth argument than it does with the equity withdrawal story. Household net worth hit another record in the second quarter, lifted by continued net gains in home values, after subtracting mortgages. Overall wealth would have risen more if not for the quarter's stock market losses, but the market has since turned around, and overall net worth should post another solid advance in the third quarter.

Most homeowners are hardly suffering. True, the median price of existing homes declined in August by 1.7% from the previous year, the first such drop since 1995, says the National Association of Realtors. But

consider that prices are up 22% from three years ago a 40% from five years ago. Those capital gains have added smartly to overall wealth, and it would take a draconian decline in home prices to erase them.

At the same time, new data from the Fed show the amount of cash homeowners are extracting from their

home equity has dropped 43% since the third quarter of last year, to an annual rate of \$497.2 billion in the second quarter. As a share of aftertax income, the amount has been cut almost in half to 5.2%. However, outside of the pinch from higher gas prices in the second quarter, consumer spending has shown



strain. Outlays could easily grow at more than a 3% annual rate in the second half, resulting in little if any slowdown in 2006 vis-à-vis 2005. The equity withdrawal crowd now argues that less cash from home values will slam spending in 2007. Stay tuned.

Clearly, the economy will not escape the downturn from the housing market's return to reality. The question is: How bad will it get? For that, look to consumers. If the burden gets too heavy, they will be the first to buckle. So far, they are carrying the load very well. ■

## LABOR MARKET

# A Job Growth Indicator Gets Iffy

**THE PATTERN OF** weekly initial claims for jobless benefits has traditionally been one of the best barometers of job growth. Now, claims are losing some of their predictive value. The reason may lie in changing demographics.

The aging of the Baby Boom generation and the steady decline of young workers in the labor force are causing a breakdown in the relationship between new claims and hiring. Older, more experienced persons typically have longer tenures at jobs. Workers 55 to 64 years old average over nine years at their company, nearly twice as long as those 35 to 44. Meanwhile, the share of 16- to 24-year-olds in the

workforce has fallen from 64.6% in 2001 to 60.7% in July. These less experienced workers tend to move in and out of the job market more frequently, and they have a higher unemployment rate.

These demographic shifts mean much less churning in the workforce, a factor that likely is reducing claim activity. Indeed, even as the population has grown, weekly claims outside of recessions have stayed in a narrow range of 300,000 to 400,000 for most of the past three decades, says JPMorgan Chase economist Michael Feroli. According to his analysis, the level of jobless claims that historically has been associated with essentially no job

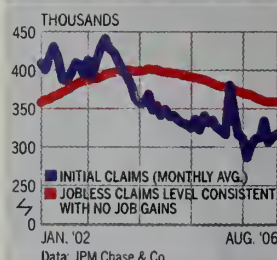
growth has declined in recent years.

Recent data show the disconnect. Over the four weeks through September, jobless claims averaged 315,000 persons, but the consensus among economists is that hiring in September was just 125,000 workers. In the past, when jobless claims around the 300,000 level, monthly payroll gains averaged nearly 250,000. So far this year, companies are adding an average of 141,000 workers per month.

Another likely impact of the demographic trend is a rise in the average duration of unemployment. "As the pool of unemployed workers has become older, they are more likely to spend a longer time looking for the right job," says Feroli. The workers either find it harder to get back into the workforce, or they are choosier about their next job.

—By James Mehring in New York

## JOBLESS CLAIMS: NOT SIGNALING MORE HIRING





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# The Business Week

## News you need to know

EDITED BY HARRY MAURER



**Running Bulls** Let the good times roll: Stocks are soaring on hopes of strong profit growth, and bond investors are betting that inflation is under control and the Fed will stop cranking up interest rates. The Dow on Sept. 27 settled at 11,689, just 34 points shy of its 2000 record. Bonds are partying, too: The 10-year Treasury note's yield, which falls when prices rise, closed on Sept. 27 at 4.60%, down from 5.25% in June (bond options pit in Chicago, photo).

Bond guru **William Gross**, managing director of **Pacific Investment Management**, told clients on Sept. 25 that the bull market in bonds "remains in its infancy." But some experts think yields this low make sense only if the economy is going cold (which, by the way, would hurt stocks). The bond market could also tumble if oil prices keep slipping and fewer petrodollars are recycled into Treasuries.

See "Consumers aren't sweating the housing slump," page 31, and "The downside of cheaper oil," page 50

**Oops, More Smoke** So much for Big Tobacco's winning streak in court. On Sept. 25, U.S. District Judge **Jack Weinstein** agreed to allow a class action alleging that **Philip Morris**, **Reynolds American**, and others misled smokers of so-called light cigarettes. With the suit potentially covering tens of millions of people, lead plaintiffs' lawyer **Michael Hausfeld** says damages could run as high as \$200 billion. The companies plan to appeal to the more conservative Second Circuit Court of Appeals in New York.

ONLINE See "Big Tobacco, back in legal limbo," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**The HP Way Out** Hewlett-Packard's self-inflicted wound claimed more victims as the company said on Sept. 22 Chairwoman **Patricia Dunn** was stepping down, and news reports said two other executives implicated in the snoo scandal would soon leave. Bloomberg News noted that FBI is involved in the inquiry, one of 486 investigation corporate fraud the agency has undertaken so far this year, up from 423 in 2005. That's on top of 1,160 security fraud cases, up from 1,139 last year.

See "Controlling the damage at HP," page 36, "Inside the HP case," page

**A \$4 Rx** If anyone can bring down drug prices, it may be **Wal-Mart**, which is seizing the opportunity to polish its image and possibly stoke traffic. On Sept. 22 the Benton (Ark.) behemoth launched a plan to offer \$4 generic drugs starting with its 65 stores in the Tampa market. It will expand the program, covering 291 drugs, to other Wal-Mart and **Sam's Clubs** in Florida by yearend and start adding states next year. Stocks of traditional drugstore chains, such as **Walgreen**, took a hit for the potential loss of cash-paying customers. **Target** and **Costco** plan to match Wal-Mart.

See "Wal-Mart, please don't leave me," page 84, ONLINE "Wal-Mart's generics hit pharma stocks," [www.businessweek.com/go](http://www.businessweek.com/go)

**Hoosegow Watch** On Sept. 26, **Andrew Fastow**, the financial whiz whose misdeeds played a central role in Enron's meltdown, was sentenced to six years of jail and two years of community service. He was led off to prison immediately—on the same day that **Bernard Ebbers**, ex-CEO of **WorldCom**, reported to begin serving his 25-year sentence for conspiracy and fraud. Fastow's testimony helped convict the late former Enron Chairman **Kenneth Lay** and ex-CEO **Jeffrey Skilling**; Ebbers is still appealing his conviction.

**Angry J&J** Even now it isn't over. Eight months after filing what seemed like the world's longest takeover bid, **Johnson & Johnson** on Sept. 25 sued the winners, **Boston Scientific** and **Abbott**, for at least \$5.5 billion in damages. The suit says the two induced medical device maker **Guidant** to breach a merger deal it had signed with J&J, then snatched Guidant away with a higher bid. Guidant already paid \$705 million for breaking off the engagement.

See "Boston Scientific's double bypass," page

**Does GM Want a Dowry?** The road to the altar is bumpy, perhaps especially for prideful auto giants. As the battle between **GM** and **Renault-Nissan** come down to the wire, on both sides have been whispering that the American company is cool to a relationship. On Sept. 27, GM Chairman **Richard Wagoner Jr.** and Renault-Nissan CEO **Carlos Ghosn** met. *The Wall Street Journal* said GM wants a multibillion-dollar "equalizing contribution" on top of the skimpy \$3.5 billion Renault would pay for a 20% stake in GM. If minds meet by Oct. 15, Ghosn is expected to turn to Ford.

ONLINE See "Will Wagoner walk away?" [www.businessweek.com/go](http://www.businessweek.com/go)



**Mother of All IPOs** Looks as if China is about to set another record. Its largest lender, **Industrial & Commercial Bank of China**, filed papers on Sept. 22 setting it up to raise \$14 billion in a dual IPO in Hong Kong and Shanghai on Sept. 27. Economic historians take note: This is likely to be the biggest IPO ever. Global investors have swarmed over the offerings by **China Construction Bank**, **Bank of China**, and others over the past year, figuring big mainland banks are the proxy play to buy into China's hypergrowth story.

See "China's ICBC: The world's largest IPO ever," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Efficient System at the SEC** Watch out, would-be market makers: The SEC is modernizing its **EDGAR** electronic corporate database, and the new one will be interactive, making it easier for analysts, investors, and investigators to find and compare data. On Sept. 22, SEC **Chairman Christopher Cox** said he would cut filing fees by 37% in anticipation of a \$54 million overhaul. Look for the upgrade to be done by early 2008.

**Cornered** You can run, but you can't hide. And no matter where you go, sometimes you can't avoid extradition. Or so discovered **Jacob "Kobi" Alexander**, the former CEO of **Comverse Technology**, who went on the lam in August after being charged with crimes related to options trading. G-men tracked him down in **Namibia**—which before Sept. 27 did not allow extradition to the U.S. But presto change-o, that morning the law was altered, and Alexander was picked up. **Justice Dept.** officials expect him on U.S. soil soon. The same day, a 32-count indictment was unsealed in Brooklyn charging Alexander with conspiracy, securities fraud, and money laundering.

### Good Deed of the Week

**Richard Branson** has made a bundle from fuel-guzzling airlines, but now the **Virgin Group** founder is going green. On Sept. 21 he kicked off the **Clinton Global Initiative** in New York, pledging to invest all future profits from Virgin's four airlines and two train companies—an estimated \$3 billion over the next decade—in renewable energy initiatives to combat global warming. It's a publicity coup but also could end up earning him money. First up: brewing new biofuels from plants, the mission of just-created **Virgin Fuels**. And the 57-year-old British billionaire's energy ambitions don't end there. He's looking at everything from cellulosic fuel made from crop waste to wind farms to trains capable

RICHARD BRANSON

running on cleaner, more efficient biodiesel. Branson's space tourism venture, **Virgin Galactic**, may be his next environment-friendly business yet, starring fuel-efficient carbon composite spaceships that generate virtually no pollution. *Star Trek's* Mr. Spock would have nodded and said: "Live long and prosper."

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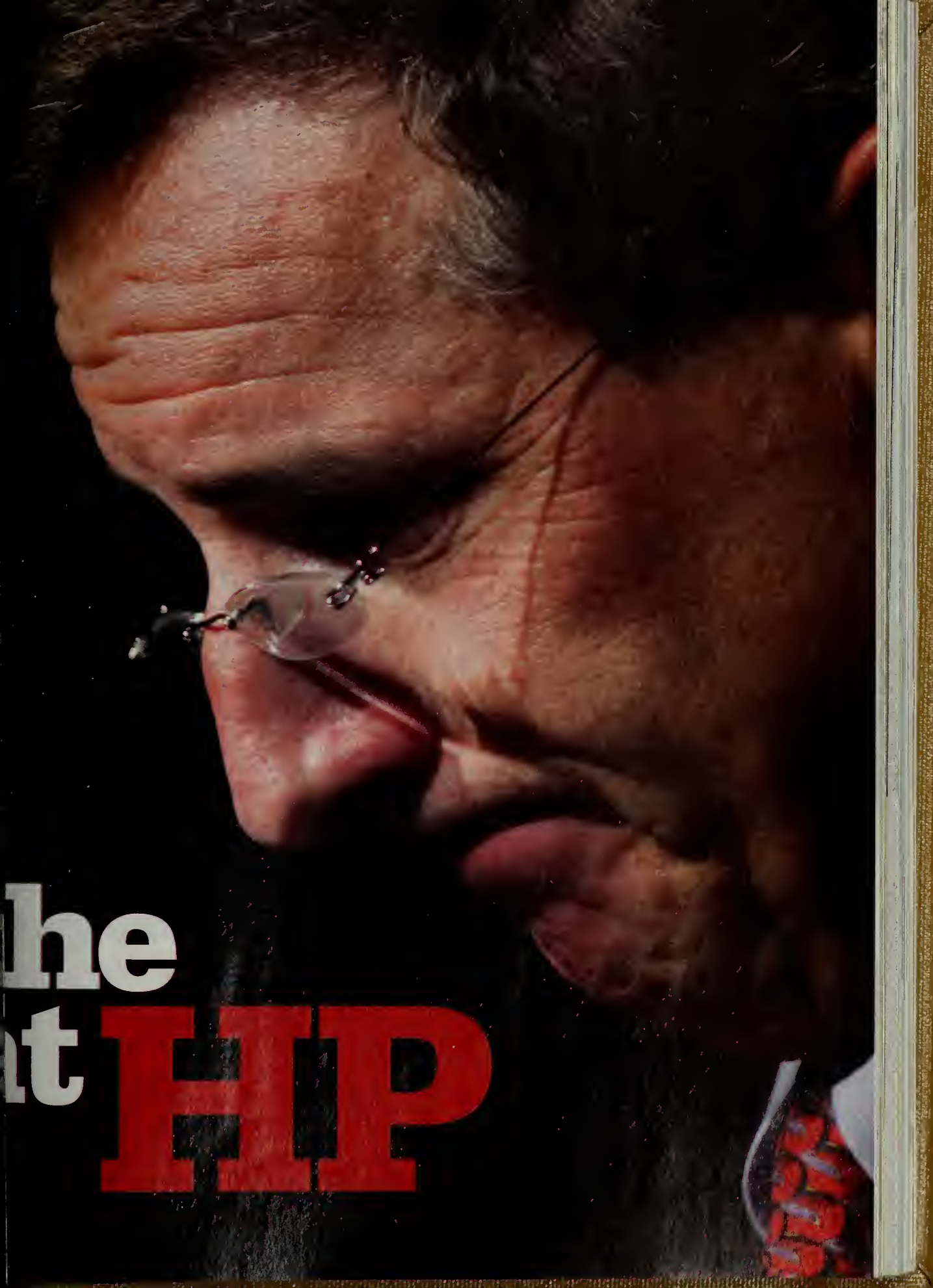


Since he replaced Carly Fiorina, Mark Hurd has led an amazing turnaround. But can he keep HP humming in the face of a bruising scandal? **BY PETER BURROWS**

**D**URING MARK V. HURD'S 25-YEAR CAREER AT NCR, the company had plenty of good reasons to launch internal investigations. There was the time 10 years ago when an angry, laid-off worker, after getting into a tussle with Hurd in a pickup basketball game, made repeated death threats against him and his family. Years later, during a painful round of cost-cutting for the 120-year-old cash register and computer maker, Hurd and other top executives had their tires slashed in the executive parking lot. NCR installed a security system in Hurd's house and hired a guard. And several times employees posted sensitive financial data on Yahoo! message boards.

In each investigation, Hurd, an executive who normally delved into the most minute details of daily operations, relied on his former chief counsel, Jon Hoak, to run the show. Hoak, who has since left NCR, vividly recalls Hurd's peering over his rimless reading glasses after one Yahoo leak and telling him: "We can't have this, so you

# Controlling Damage



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## HP: The Carly Years, Recovery, and Scandal



**July, 1999** Carly Fiorina is as CEO of Hewlett-Packard.

**November, 2001** Founding family member Walter Hewlett publicly opposes Fiorina's plan to acquire Compaq.

**May, 2002** Following a narrow proxy fight, HP acquires Compaq.

out and do what you have to. Just make sure everything we do is legal and above board."

Sound familiar? The parallels with the drama that's playing out today at Hurd's new employer, Hewlett-Packard Co., are striking. To hear Hurd tell it, when HP's then board chairman, Patricia C. Dunn, authorized an investigation into press leaks from the board, he also trusted that she and the company's legal and security personnel would handle it properly. Hurd figured he had enough work resurrecting the company. On Sept. 25, red-eyed and clearly humbled, Hurd explained to *BusinessWeek*: "I'm a detail-oriented guy by trade. But when you have a place of this scale, you have to pick your spots where you're going to go dive. Compliance wasn't the first process I was going to go look at. I was going to go look at the performance of the company."

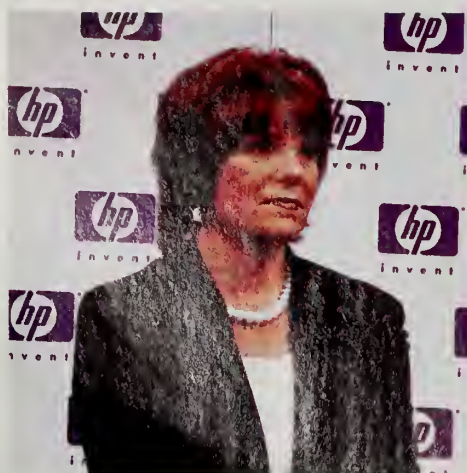
Even if Hurd is right about being mostly out of the loop, it's a decision he surely regrets. On Sept. 22 he stood before a room of reporters and read a statement apologizing for the spying tactics that HP officials and security subcontractors used to track down the source of leaks. Hurd admitted that he was not paying close enough attention to spot some of the actions, which he called "very disturbing." In the coming weeks, his version of events will be tested—through testimony by Dunn, Hurd himself, and other HP officials before Congress on Sept. 28, and in various criminal investigations that are under way.

**Editor's note:** Writer Peter Burrows is one of the reporters whose private phone records were sought by investigators for Hewlett-Packard.

So far, there's little sign that the scandal will sidetrack an otherwise rousing turnaround story at HP, managed by the 47-year-old executive that some in Silicon Valley—at least until recently—had taken to calling the "Boy Wonder." HP's stock price faltered only when investors worried that Hurd's job was in jeopardy: They had discounted the scandal until it threatened the leader who restored their faith in the company.

## What Morale?

IT SEEMS HIGHLY UNLIKELY that Hurd will be forced to resign. But the question for employees and shareholders of the \$90 billion company is whether he can remain focused on performance. He spent three days in Washington preparing for his congressional testimony and will also have the duty of rebuilding a board whose atmosphere had turned poisonous in recent years. Hurd took over as chairman after Dunn was ousted on Sept. 22; he had already trying to recruit replacements for her and the two directors who quit in the fallout over snooping, Thomas J. Perkins (page 120) and George A. "Jay" Keyworth. "What you have is a board that has had more infighting with themselves than with me," Hurd says. "At the end of the day, we have to do the same work with the board that we've done with the company—that is, to rebuild its very foundation."

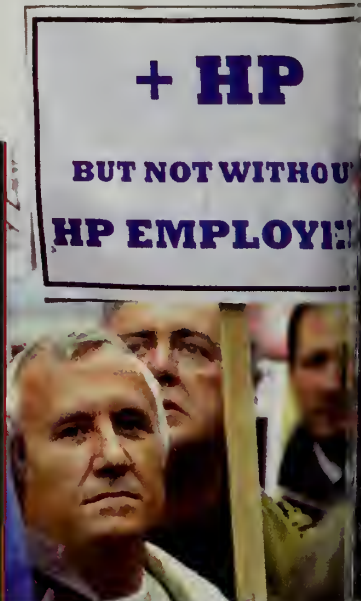


**Early 2005** Non-executive chairman Patricia Dunn launches probe into press leaks by directors.

**July, 2005** HP announces layoff of 15,000 workers.



**May, 2006** When HP's board moves to oust director Jay Keyworth for press leaks, Tom Perkins angrily quits.







**August, 2004** HP badly misses quarterly projections, sending shares down 15%.



**February, 2005** Fiorina, furious over press leaks and slow to share power, is ousted.

**March, 2005** Mark Hurd succeeds Fiorina as CEO.



entirely separate from the scandal, Hurd faces major challenges to keep HP's recovery on track. So far, he has cranked up savings through smart cost-cutting moves, which have streamlined the company's operations and enabled it to take market share in products such as printers and PCs. There's certainly room for near-term growth in existing sectors. But at the same time, HP will need to create major new markets, as well, to stay in Wall Street's good graces. Many insiders wonder if Hurd is up to that. Says one longtime HP manager: "I think the honeymoon will last another year, until analysts start wondering where the next growth will come from."

Already, the scandal is filtering into Hurd's day-to-day management style in surprising ways. He says half-jokingly that he finds himself repeatedly telling employees in meetings whatever they do has to be "legal and ethical." "We're going to have to regain the world's confidence one person at a time. To prove that this is the company they thought it was," he insists. Weighing in Hurd's favor is that HP's workers really want him to succeed. They seem more numb than outraged by the scandal—sadly predictable, perhaps, after years of corporate intrigue and layoffs. It has been years since HPers viewed their company as a paragon of ethical behavior. "I don't think it's affecting morale, because the HP Way has been dead for years," says one staffer. "People are just glad to have some options that mean something again."

During the 18 months since jumping from Ohio to California,

Hurd seemingly could do no wrong. He recruited just the right number of outsiders into top jobs, pushed through a 15,000-person layoff and other moves to trim the company's annual costs by billions, and boosted operating margins from 4% to 6.9% in the past year. As unlikely as it would have seemed two years ago, HP has put PC king Dell Inc. on the run and will overtake IBM in revenues this year. Its shareholders have been rewarded with a nearly 80% rise in the stock price since Hurd took over.

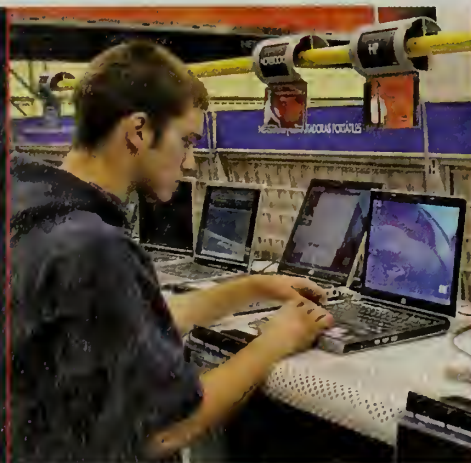
## Being the anti-Carly isn't enough. Now, Hurd must find new markets

Perhaps most impressively, Hurd buried the ghost of his charismatic but controversial predecessor, Carleton S. "Carly" Fiorina. Once Hurd set foot in Palo Alto, it was clear he was the anti-Carly. HP employees who Googled his name may have been given pause by the reports of cost-cutting at NCR, but they found hope in the dearth of personality profiles of their new CEO. Whereas Fiorina once had her portrait hung between those of founders William R. Hewlett and David Packard in HP's lobby, Hurd refused to put his own picture up. Today, Hurd appears dispassionate about his predecessor, to the point where he claims not even to be aware that she'll appear on *60 Minutes* on Oct. 8 to pump her new book, *Tough Choices*. Hurd, who has no grudge and has been careful never

**2006** HP software firm Interactive Intelligence acquires a billion, Hurd's first major acquisition.



**2006** HP confirms the existence of former director's laptop that it had spied on employees' home phone records in connection with litigation into leaks.

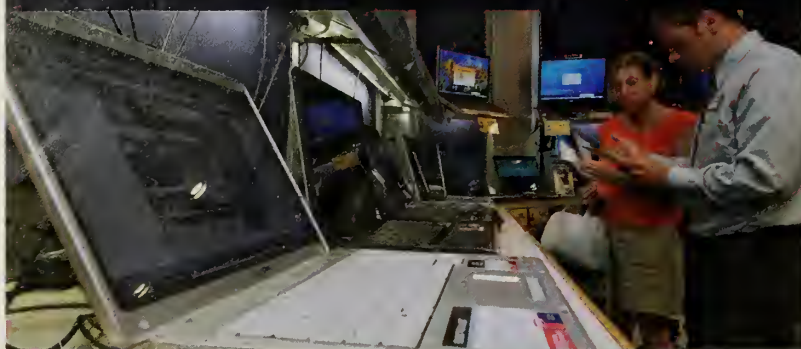


**Sept. 22, 2006** Hurd apologizes "both personally and on behalf of HP" for its tactics in the leak investigations. Hurd and Dunn offer to testify before a congressional subcommittee on Sept. 28. Dunn leaves the board.

Kevin Hunsaker, HP's ethics lawyer and senior counsel, and security manager Anthony Gentilucci are expected to leave.



## Four Keys to a Turnaround



### Boost the Bottom Line

**1** A big 2005 layoff will save \$1.9 billion a year, and Hurd is selling office space and reengineering functions such as IT. As a result, HP churned out \$4.7 billion in operating income the past nine months. And its operating margin is 6.9% through July, up from 4% in '05.

### Make a (Smart) Deal

**3** Before Hurd, HP had an abysmal record with acquisitions. But its purchase of photo-printing site Snapfish is working well. Now it hopes to compete better with IBM following a \$4.5 billion deal for Mercury Interactive.

### Attract Talent

**2** For years, HP kept its own but rarely lured outside stars. But Hurd brought in Randy Mott, Dell's hotshot CIO, to oversee data operations; two key Palm execs, Todd Bradley and Satjiv Chahil, to help run the PC unit; and Thomas Hogan of Vignette to head up software.

### Sell, Sell, Sell

**4** Hurd nixed an über-sales staff in favor of one that allows the sales force to focus on the products they know best, and he invested in almost 1,000 new salespeople to improve the coverage of major accounts.

to criticize her, says he'll watch Fiorina's TV interview "if I'm around, and if it's on in the room I'm in."

Some expect Fiorina to take a measure of credit for HP's comeback. Hurd himself admits he's pretty much running her strategy, albeit in a much more focused, disciplined way. "Mark could have been the best COO on the planet for Carly; they would have been a great team," says one HP executive. In terms of style, though, the two couldn't be more different. Fiorina's public presentations were choreographed like rock shows. One of her credos was that "management is a performance." Not so with Hurd—unless you relish sitting through a dreadfully detailed nine-hour business review.

On his first visit to HP's Boise (Idaho) printer operations, where old-timers particularly disliked Fiorina, Hurd won points by driving up in a Hertz rental car, says one former executive. During his standing-room-only talk in the cafeteria, he scribbled on a flip chart the price-earnings ratios for IBM, Dell, and HP. "You know why ours is down here?" Hurd asked. "Because shareholders don't believe we can do what we say we'll do."

Even when he's taking subordinates to task, Hurd is more likely to challenge than to chastise. "With Carly, you'd walk out like you were a bad child and were going to be punished," says one HP vet. "He talks like your favorite professor, leading you through things until you understand it."

To understand how far Mark Hurd has lifted HP, you must first consider the trauma it has gone through. Fiorina arrived in 1999, after board members pushed out unexciting CEO Lewis E.

Platt. HP was seen at the time as a laggard that rived late to the dot-com party. IBM under Louis Gerstner Jr. had jumped into computer services a big way, while HP slogged along selling servers, PCs, and printers. The board bet that Fiorina, a star sales executive at Lucent Technologies, would shake the company out of its slumber with her charisma and ambition.

She accomplished that, in spades. Within weeks, Fiorina had raised HP's profile with emerging as one of the world's most recognizable celebrity CEOs. Reality never matched the hype, though. Her ambitious efforts to transform HP quickly bogged down, particularly a complex restructuring that undercut the clear accountability that had been the bedrock of the company. Soon enough, HP's financial performance grew unstable, the stock sank, and employees lost faith in her ideas. As they did, they began to resent her look-alike management style.

As problems became visible within Fiorina's company, they also began to emerge within the board. For decades, HP's directors were a stable group dominated by longtime friends and progeny of the founders. But it then played a controversial role in backing Fiorina's decision to buy Compaq Computer Corp. in 2001. First, the board O.K.'d the \$25 billion merger despite the concerns of scion Walter Hewlett. When the deal came under withering criticism from investors, the company called on directors—particularly Keyworth—to sing Fiorina's praises to the press and discrediting Hewlett, who nearly won a proxy fight to kill the deal. "They were not people acting like honorable people. That's what we're really seeing: the fall from that," says one HP insider from that time.

As HP continued to struggle to meet its goals, more rifts emerged within the board. By late 2004, directors that included Keyworth, venture capital bigwig Perle, and longtime HP executive Richard A. Hackborn began to demand better performance. When Fiorina resisted calls to step down from her operating duties, the spat found its way into the press. (When Fiorina suspected Keyworth, he was not the source of that leak, according to his lawyer.) On Feb. 7, 2005, with Fiorina still in the firing line over the leak, Dunn and others offered to accept her resignation. Fiorina refused, choosing to be fired rather than give the impression she would leave a job undone.

## Change of Horses

ENTER HURD. His candidacy to replace Fiorina and run the 11th-largest U.S. corporation at first seemed like a long shot. The name was initially mentioned by headhunters relatively late in the process, and didn't make much of an impression. On the board, a member joked: "NCR? That's in Iowa, isn't it?" Fiorina, somewhat spooked by the articles about Fiorina's ouster, his interest was only "mediocre," as well.

But Dunn persuaded the other two members of the selection committee, Keyworth and Perkins—the two she would later enrage with her leak investigation—to meet Hurd at the San Francisco office. They were quickly won over. Dunn showed a deep understanding of the way HP really made money, and they were impressed to know that each year he tra-

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how he spent his time to make sure it was split equally among employees, customers, and investors. Hurd also eschewed any notion of quick fixes. Says Keyworth: "I picked him one hour after we met him."

Hurd almost balked at taking the position. The size of the job was daunting and, perhaps prophetically, he was worried about leaks after getting a call from a *BusinessWeek* reporter who said Hurd was likely to be named HP's next CEO. According to one source involved in his recruitment, Hurd said: "I don't want to go to a company that has a goofy board." He felt it was important to have a board that spoke with one voice. It took Hackborn's flying to Dayton for a two-hour talk to get him back to the table.

In the end, Hurd couldn't resist the opportunity. "It was a chance to play in an arena he has always wanted to be in," says retired NCR executive Bill Eisenman, a long-time mentor. "This was a chance that would only come around once in life."

He was ready. All his life, Hurd had been confident. As a stockbroker's kid growing up on Manhattan's East Side, he put far more energy into sports than into grades. He was a tennis standout in high school and then at Baylor University, but gave up on dreams of a pro tennis career for something more lucrative. He found sales. After joining NCR's Dallas office in 1979, Hurd quickly became the only computer salesman there to make his quota. He also met his future wife, Paula, who moved up the sales ranks along with him until quitting when he became company president in 2001. He moved up to corporate. Lee Panosian, a former NCR colleague who is now vice-president for global strategies at Lenovo, recalls walking for hours with Hurd through their Centerville (Ohio) neighborhood, smoking stogies and strategizing about how to land a deal or the optimal deployment of field salesmen.

## When Hurd arrived, HP was hungry for his informal, straight-talking style of leadership

### "Torture the Data"

WHILE MANY OF HIS PEERS jumped ship after AT&T's takeover of NCR in 1991, Hurd smelled opportunity and stayed put. A few months later, AT&T bought Teradata, a maker of high-end data mining computers. It was a perfect match: Hurd helped the unit make inroads on Wall Street, in the Pentagon, and with huge corporate customers such as Wal-Mart Stores Inc. In the mid '90s, he oversaw the decision to get out of the commodity PC business and put all of Teradata's energy into machines running its sophisticated, market-leading software.

Hurd became known for his disdain for glossy, Band-Aid solutions that sounded good in a presentation. Instead, he would call people in the organization three or four levels down to get the details on some minute operational question. His muse was Teradata's own software, which he would use to run scenarios and simulations for how to achieve the lowest costs and highest sales. "There was a saying at NCR: Mark would torture the data until they confessed," says Steve Millard, who was Teradata's vice-president for global strategic partners.

In many ways, the table was perfectly set for Hurd's arrival at

HP. He stepped into a company with 150,000 people hungry for his informal, straight-talking style of leadership. He immediately jelled with rank-and-file and veteran managers alike, many of whom had long since tired of Fiorina's soaring rhetoric and simply wanted clear, smart direction. "We had grown used to hearing vision and abstractions, but nothing you can sink your teeth into. It doesn't mean anything," says one insider.

Several Fiorina initiatives were teed up and ready to deliver. Chief Technology Officer Shane V. Robison had finished an exhaustive benchmarking study, giving the data-addicted Hurd plenty to chew on. The printer group, which was still dominant but facing increased competition and falling prices, had already begun a project that would involve hefty job cuts and reallocation of spending to the most promising projects. After years of playing the patsy to Dell, even HP's PC division was making so much progress and had much improved products in the pipeline.

But huge changes were under way that would enable HP to start keeping its promises. Hurd gave the heads of the major businesses far more control over such things as their own sales forces and marketing dollars. He killed projects that seemed designed to gain PR rather than profits, such as reselling Apple iPods. And he began a slew of investments to increase the efficiency of corporate functions, especially a state-of-the-art distribution warehouse and lightning-quick information systems network. The central cog of Hurd's plan: pump the billions saved over time into the engineers and salespeople who could keep the company growing. "It's not a Phase 1, Phase 2 thing," he says. "It's a continuous thing. We have to grow and cut costs simultaneously."

Sales may not be as sexy in Silicon Valley as a new multiplayer or Web service, but it has been a critical factor in HP's turnaround. Besides nixing an über-sales staff for one that focused on salespeople focus on the products they know best, Hurd brought in almost 1,000 new reps to improve service to major accounts. And he carefully targeted areas that had been unaddressed. While HP always sold printers and consulting services, it never provided services to help companies manage all their printers, as IBM did. Says Hurd: "The consistent message I get from customers is: We just don't show up enough." Adds Intel CEO Paul S. Otellini: "He really has reenergized their sales forces."

Also crucial to the recovery is Hurd's success in attracting top outsiders to push through his agenda—traditionally an HP strength. Former Dell Chief Information Officer Richard D. Mott is pushing his staff to the breaking point to replace 87 poorly integrated data centers to create that cutting-edge network. Ex-Palm CEO Todd Bradley now runs the resurgent \$27 billion PC unit, with the help of former Apple marketer Satjiv Chahil. Says HP board member Bob Rowley: "Before Mark arrived, you had a lot of ideas but not a lot of execution. There were too few operating managers—people who can really run businesses."

What's most striking about Hurd's work is not the

### Deeper into the Doings at HP

**HEAR** a podcast interview with correspondent Peter Burrows by Executive Editor John A. Byrne at [www.businessweek.com/go/cover\\_podcast](http://www.businessweek.com/go/cover_podcast).

**WATCH** HP's grabbing trash bags in the dark of night in New Jersey at [www.businessweek.com/extras](http://www.businessweek.com/extras)

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strokes, but the many smaller ones. He has demanded accountability in a company that had gotten lazy, in any number of ways. One staffer notes that he is now questioned on expense reports if he goes over \$45 for a dinner. Many say this renewed focus on details starts at the top. While Fiorina rarely sat in on divisional reviews, Hurd not only holds them but keeps staffers busy with his follow-ups. Former software chief Nora Denzel marvels at one meeting held to discuss the cost structure of HP's customer service group. At one point, Hurd got interested in what cars tech reps drove when they had to make an on-site repair. How many had company cars? How many didn't have their own cars they could use? What model cars did HP provide, and were they automatic or manual?

Denzel says Hurd is "tough, but fair." Once, her software business missed its targets when expected deals didn't materialize in the final days of the quarter. She approached Hurd's of-

fice with trepidation, but once she had explained the reasons, asked what he could do to help. She named three things: Call one regional sales leader to push him to focus more on software, call another to insist he make a key hire, and call an analyst who was spreading talk that Hurd was going to divest the software group. "I asked for three things," Denzel says. "By the time I got back to my office, they were all done."

Now, Hurd must apply that detail-oriented mindset to scandal that has cast such a pall over HP's recovery. The E-Myth Wonder must oversee an investigation, respond to criminal probes, hire new directors, and make his quarterly numbers, while under the glare of scrutiny he could have never imagined back in Dayton. ■

—With Louise Lee and Robert D. Hof in San Mateo, Ca  
Adrienne Carter in Dayton, Lorraine Woellert in Washington, D.C.  
Moir Herbst in New York

## Q&amp;A

# 'I Should Have Figured It Out'

Mark Hurd on what he knew, when he knew it, and what happens now

**IN HIS FIRST INTERVIEW SINCE** publicly admitting he should have taken a more active role in preventing the HP board scandal, CEO Mark Hurd talked with *BusinessWeek* correspondent Peter Burrows on Sept. 25. Here is an edited version of their conversation about the investigation.

**You have said you missed most of a meeting to discuss the leaks investigation in mid-2005, that you didn't read a key report earlier this year, and didn't know that an e-mail being sent to a reporter from a made-up HP executive had tracing software in it. Those sound like excuses to some. What should people make of this?**  
That I should have figured it out sooner. I'm not trying to shirk it. I wish I would have figured it out sooner.

**Do you have any reason to believe your job is in danger?**  
No.

**Why didn't you read the summary report of the investigation that was completed in March?**

The whole subject of the discussion [before he received the report] was "what's the answer [to the identity of the leaker]?" My first thought was that this was really, really bad news. You had a really good board member [Jay



Keyworth] who had made tons of contributions to HP over the years.

I'm not trying to justify the fact that he leaked a news story to CNET or whoever, but I knew this was going to be tough stuff. The guy had done a lot for the company, and had a lot of support—not just on the board, but in the company. But when

you get that kind of data, my instinct is to escalate it. Pattie [Dunn] did say: "What do you think we should do with this?" I said you have to escalate this up through the chain [to the board's audit committee and to the outside counsel]. She did that, which I think was the right process to go through. So my first reaction wasn't to say: "Tell me how we did this."

**You've said that the reason Keyworth was ousted from the board was that he violated HP's standards of business conduct (SBC). Did you violate those standards as well?**

I don't think so. I've read through the

document multiple times, but I can't go any further than that. I think there's a different question than just: Did I violate the SBC? I'm the CEO, so right or wrong you're accountable for what goes on in the company.

**What do you hope to accomplish with the investigation you're now leading?**

It's the whole ethics and compliance process. Let's review the standards of business conduct, to make sure we feel good about it and it's up to date and it's aligned with our values. I just think we need to put fresh eyes on it, and look at it as a zero-based budget kind of thing....

It sounds absolutely nuts, based on the circumstances we're in. But sometimes it creates an openness to change. And I can't think of anyone more open to change than us.

**HP was doing so well before this. Will this be a temporary bump in the road or a permanent blot?**

This happened on my watch. Like it or not, you get credit for the good stuff and the bad stuff. But at the end of the day, my scorecard is less relevant than HP's. At the end of the day, what matters is whether HP is the kind of company that everyone respects and trusts, so it can take advantage of its opportunities in the marketplace. I've got to make sure that happens. The people of HP didn't do this. ■



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A close-up photograph of a person's neck and chest. They are wearing a dark suit jacket, a white dress shirt, and a red tie with a dark, textured pattern. The tie is covered with several pairs of large, realistic-looking human eyes, some looking forward and others looking to the side. The background is a bright, solid yellow.

# Corporat



It was Spy vs. Spy.

Jerry I. Treppel had begun to suspect that someone was going through the garbage that he placed on the curb twice a week outside his central New Jersey home. Engaged in a bitter feud with Canadian drugmaker Biovail Corp., Treppel, a former pharmaceutical analyst for Bank of America Corp., even had an idea who might be doing it. To be certain, he hired a private investigator.

Sure enough, in the wee hours of the morning during several weeks in the fall of 2005, the PI, positioned behind a fence, followed two men as they drove up in a gray minivan, grabbed Treppel's trash, and even put some replacement garbage back in the cans to try to cover their tracks. "I live in Edison. The package [they put in] was from Perth Amboy," Treppel says. (It included, among other things, pieces of discarded mail.)

Trailing the men back to their homes, Treppel's gumshoe quickly identified the men as Michael Specht and Edward Wong, investigators who live in neighboring towns on Long Island, N.Y. Figuring out who had hired the two men would prove surprisingly easy. After Treppel subpoenaed Specht and Wong to appear for depositions in a lawsuit he is pursuing against Treppel, an attorney for the two responded by letter, stating that they "were retained counsel for Eugene Melnyk," Biovail's spokesman. In an e-mail comment to *BusinessWeek*, a Biovail spokesman said the company wanted to determine if Treppel was destroying evidence that might be relevant to the litigation. Treppel and Melnyk have asserted claims against Biovail for defamation, growing out of Treppel's coverage of Biovail.

Compared with the techniques employed by Hewlett-Packard Co. in trying to discover the source of its boardroom

# noops

...rifting through someone's trash is pretty tame. "Dump-diving," as it is commonly known, is generally legal. Obnoxious phone records through impersonation, the way HP investigators did, may be a crime. But both the HP and Biovail investigations stand out as rarities: The victims actually found out they were being spied upon. Most people whose private letters, telephone records, and e-mails are scrutinized by unscrupulous snoops never find out.

As the HP surveillance scandal unfolds, and new details emerge about how the tech titan pried into the lives of board members and journalists, it is becoming clear that even the most blue-chip companies are sometimes willing to hire private spies. HP is hardly an isolated example. Several prominent Hollywood bigwigs and attorneys used the services of Anthony Pellicano, the private investigator whom federal prosecutors indicted in Los Angeles in February for illegal wire-

tapping. And Oracle Corp. acknowledged in 2000 that it hired detectives who had attempted to obtain the trash of a think tank that defended the aggressive business practices of its archrival, Microsoft Corp.

Then there are the cases we never hear about. Even when a company catches a rival spying, the matter is generally resolved quietly, says John A. Nolan III, chief executive of the Phoenix Consulting Group Inc., a business-intelligence firm in Huntsville, Ala. "The guys who are having their clocks cleaned don't want their shareholders knowing," he says.

Executives who hire private investigators share some common characteristics. For starters, they are often desperate to get their hands on sensitive information: Who is leaking my company's secrets? Why is this person attacking my reputation? When is my competitor releasing its new product? Where are my goods being counterfeited?

Second, those who retain investigators are unable to get the answers to their questions through ordinary means. That's where the corporate spies come in. They do things that most managers either can't or won't: tail people, adopt false identities, trespass on private property, and dig through arcane electronic databases. "Our industry is useful and is needed," says Michael J. Hershman, head of the Fairfax Group, an investigative firm in McLean, Va., that he founded in 1983. "Corporations are under attack from many criminal elements, both internal and external."

Finally, the managers who hire PIs often feel their foes are fighting dirty. Defendants in asbestos suits, after years of paying off people with weak cases, have increased their use of detectives to scrutinize suspicious claimants. Targets of aggressive interest groups have also been big consumers of corporate espionage services. The owners of Ringling Brothers & Barnum & Bailey Circus, for instance, paid agents through much of the 1990s to infiltrate groups such as People for the Ethical Treatment of Animals, according to court filings and testimony of former employees.

Corporate demand for PI services has grown steadily since the 1980s. One reason is globalization. There is heightened need for information about people or companies in far-flung locations. Then there's the fact that the most valuable asset of corporations these days is information—a company's ideas and innovations. That's a lot easier to steal than, say, a machine press. Foreign companies in particular, Hershman says, "are extremely aggressive in seeking out proprietary information to get an advantage." Employees, meanwhile, may be more ready to give that information up, since many feel less loyalty to their employers than workers used to. Finally, a wave of statutes, from the Foreign Corrupt Practices Act to Sarbanes-Oxley, create potentially severe penalties for companies that aren't aggressive about rooting out fraud.

The vast majority of work PIs undertake for business clients is routine and aboveboard. A whole industry has arisen that specializes in routine background checks for rank and file employees. But when big companies want to bring on a top officer or a director, they'll often get a PI firm to do a deep dive on a candidate's past. That may involve old-fashioned shoe-leather techniques, including visits to neighbors and former colleagues.

In the wake of the HP scandal, some of the more established



## Dogged Digging

Here are a few techniques used by corporate investigators



## Phantom Interview

An investigator posing as a job candidate but just seeking information

## Dumpster Diving

Combing through trash to find documents and other evidence



private investigative firms are arguing that most legal and ethical abuses are committed by smaller outfits. HP assigned the leak probe to Security Outsourcing Solutions, a tiny Boston PI firm. Some of the work was then subcontracted out to other firms. The PI field is bedeviled by "cowboys," who "will do whatever needs to be done to make the client happy, whether it's illegal or not," says the Fairfax Group's Hershman. "We're constantly battling the folks who are on the edge, and frankly there are a lot of them."

The behemoth of the corporate intelligence world is New York-based Kroll Inc., a unit of Marsh & McLennan Cos. With nearly 4,000 employees in 25 countries, Kroll reported 2005 revenues of \$946 million, though only a portion of that came from PI work, since the firm offers many other services. Hundreds of midsize and boutique firms such as Fairfax, some bristling with former prosecutors or federal agents, also cater to the market. They typically charge by the hour, with rates ranging from about \$125 to \$400 an hour.

All in all, about 60,000 private investigator licenses are active in the U.S., according to an estimate by *PI Magazine*. It is not uncommon for a license to be issued in the name of a firm, which means many individuals may operate under it. "There's also a huge, unlicensed market out there," says Bruce Hulme, legislative director for the

National Council of Investigation & Security Services.

Big companies often turn to obscure players to do their dirty work. Consider Spyro Contogouris. He is "an operative" who short-sells hedge funds that pay him to drive down the price of stocks [and] otherwise to secure material nonpublic information," according to a complaint filed in New Jersey's Superior Court by Fairfax Financial Holdings, a Toronto-based insurer. In addition to Contogouris, defendants include a host of hedge funds and individuals.

## Sleazy Antics

ON MAY 31, ACCORDING TO Fairfax' complaint, Contogouris "lied his way past security" at a Fairfax subsidiary in London by stating that he was a reporter conducting a survey. The next day, Contogouris, who also hands out business cards, stated that he is a "special situations research consultant" for "MI4 Reconnaissance," hand-delivered an unmarked package to Fairfax' former chief financial officer, Treva Ambridge. It contained a letter that tried to induce Ambridge to divulge inside information, Fairfax' suit alleges. "I would like to lay out a series of maps, flow charts, and related exhibits which I have put together that I feel are missing

brilliant

cretins

## Infiltration

Snoops go undercover and take jobs in organizations or businesses to gather intelligence

## Surveillance

Someone to monitor contacts or assess the value of a disability claim



cal pieces," the letter stated, according to an excerpt in a complaint. Then came what Fairfax alleges was a "veiled" attempt at that failure to cooperate would result in Ambridge's criminal prosecution." Ambridge alerted Fairfax. "The allegations in the lawsuit are without merit," said a spokesman for Contogouris.

The alleged antics of Contogouris may seem sleazy, but hiring big brand-name investigative firms is no guarantee of avoiding controversy. For the past three years, several Russian businesses have been battling for control of a 25% stake in Megafon, a large Russian mobile-phone company. Much of the wrangling has taken place in arbitration proceedings in Switzerland, but part of it recently landed in U.S. courts. Two prominent American investigative firms have been caught in the fray.

In a complaint in federal district court in Washington in May, IPOC International Growth Fund alleges that Diligence, a Washington-based investigator, infiltrated a confidential examination of IPOC's affairs being conducted by KPMG Financial Advisory Services for the Bermuda Finance Ministry. IPOC alleges that Diligence did this through impersonation of United States and/or British intelligence agents," and that it obtained confidential documents from KPMG's inquiry through "fraud and bribery." Founded in 2000, Diligence is a relative newcomer to the

corporate investigations business. But it is nothing if not well connected. Richard Burt, a former assistant Secretary of State and U.S. ambassador to Germany, is executive chairman, and the firm's advisory board includes William Webster, former head of both the CIA and FBI, and Thomas F. "Mack" McLarty, former chief of staff to President Bill Clinton. Diligence did not return a call seeking comment.

In Geneva, meanwhile, in May, 2004, Bernard F. Meyer-Hauser, the chairman of the arbitration panel hearing part of the Megafon dispute, announced to the parties, each represented by prominent U.S. law firms, that he had filed a criminal complaint with the Swiss police. The reason, he said, was that he had "been shadowed by several investigators" who had "watched my house" and "taken photographs of all my contacts within the last four weeks."

Meyer-Hauser said local PIs told him and the police that they had been retained by Kroll out of its London office. He said they appeared to be looking for evidence that he had been bribed. (He denied receiving any bribes.) Meyer-Hauser also said that an effort was made to get access to his personal bank account by someone who spoke English and said he was calling from London. The person knew Meyer-Hauser's Visa account number and wife's name but tripped up by giving the bank representative a partially incorrect address. In an e-mail, Meyer-Hauser, a Zurich attorney, declined to comment. A spokeswoman for Kroll said: "We don't break the law and don't ask others to do it for us."

Big firm or little firm, the bottom line is clear: Any client who hires a corporate detective is taking a chance. That's because the PI industry is full of people who are not aware of the many legal, ethical, and public relations traps that surround big companies. Detectives frequently come from law enforcement, where "few people would disagree that it's O.K. . . to lie to suspects who are rapists and murderers and child molesters to trick them into giving information," says Alex Kline, a solo investigator in San Francisco who has worked for a number of larger agencies. But when these people transfer to a private setting, "it can lead to disaster if they don't use good judgment." ■

## Hiring big, brand-name firms is no guarantee of avoiding controversy

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## THE ECONOMY

# THE DOWNSIDE OF CHEAPER OIL

If the flow of foreign oil profits into U.S. Treasuries slows, interest rates could rise

BY CATHERINE YANG

**N**OBODY EXPECTED interest rates to be as low as they are today. With durable goods orders falling and a slowing U.S. economy, many forecasters expect rates to drop even further.

But here's something to consider: One reason long-term interest rates are so low is that oil producers, enjoying a spike in fuel prices, raked in petrodollars and put much of their profits in U.S. Treasury bonds. Now, as oil prices fall and fuel-producing nations find more ways to invest and spend within their borders, fewer petrodollars may flow into U.S. government securities. That could put upward pressure on America's long-term interest rates. "It will be the sting in the tail," says George Magnus, senior economic adviser at UBS in London.

To understand how this could happen, witness how oil-producing countries have been investing their billions of petrodollar profits over the past year. When the price of a barrel jumped from

\$66 on the New York Mercantile Exchange this January to \$75 in July, the trade surpluses of oil-producing nations jumped along with them. In 2006 their surplus is projected to eclipse that of Asia, according to the International Monetary Fund, with fuel exporters expected to generate a \$505 billion surplus, vs. \$462 billion from Asian nations.

Much of that money ended up in U.S. Treasuries. Banking officials can't pin down the exact total of petrodollars invested in these notes and bills since purchases made through financial intermediaries in London and elsewhere are not counted toward the fuel exporters' share. Although oil exporters' aggregate holdings of U.S. paper are dwarfed by those of Asia, data show that oil-exporting countries have recently taken the lead in buying U.S. bonds and Treasury bills. The rate of

petrodollar purchases of U.S. Treasury jumped by 61% from July, 2005, to July 2006, Treasury Dept. stats show, while Chinese investment in Treasuries grew only 12% during the same period. "The exporters are outpacing China," says Peter Ashworth, senior international economist at Capital Economics, a London consultant. He argues that it is oil exporters' additional spending, not their total purchases to date, that affects the direction of long-term interest rates.

## A "CONUNDRUM"

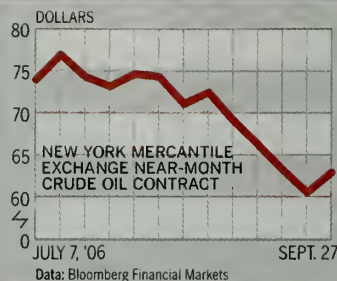
THE PROBLEM IS THAT oil prices have begun to fall. If they tumble to \$50 a barrel, the boom in petrodollar purchases of U.S. securities could evaporate. That would affect long-term interest rates more than almost anything the Federal Reserve could do. The Fed, after all, sets only overnight bank-lending rates. Last year, those short-term rates have had less to do with determining U.S. long-term interest rates than has the influx of foreign purchases of Treasuries—a phenomenon former Fed Chairman Alan Greenspan last year called a "conundrum." High oil prices and a strong dollar also boost the price of Treasury bonds. Then, because they pay a fixed interest rate, their rates of return fall.

Still, few would cry over sinking oil prices. After all, it puts more change in the pockets of American companies and consumers. And because those businesses and consumers pay less to oil-exporting nations for fuel, the U.S. trade deficit with those countries shrinks. What's more, a weak or uncertain economy, U.S. investors will fill some of the gap by buying government bonds, as they have been recently.

But don't expect countries that have been major investors in U.S. Treasuries to continue their buying spree, experts warn. China, for one, is attempting to slow its export-led growth and plan to spend more of its trade surplus on domestic consumption. Fuel-exporting nations will likely follow suit, says senior economist Nikola Spatafora.

China is already planning to boost domestic investment and economic development at home. Oil-producing Russia, which has more than tripled its holdings of Treasury securities since 2005 to \$200 billion, has a large domestic economy that will also benefit from the return of petrodollars. ■

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## HEALTH CARE

# UNITEDHEALTH VS. HCA: IT'S UGLY

Their contract dispute is leaving patients and docs out in the cold

BY JOSEPH WEBER

**A** DENVER-BASED EXECUTIVE with UnitedHealth Group Inc., in a blistering battle with popular local hospitals, finds "insurance pig" scrawled on his house. In Atlanta, insurer WellPoint Inc. takes a jab at one of the toniest hospitals in the city, slamming it in a newspaper ad for treating too few low-income patients. And in both cities, negotiators rush from the bargaining table to court, arguing about everything from false advertising to greed. All the while, hundreds of doctors must scramble to change hospitals as thousands of patients fret over where they'll be treated.

Contract talks between insurers and hospitals have never been pleasant. But for sheer nastiness they are beginning to rival old-fashioned labor-management tussles, minus the police and water hoses. "We're seeing more and more of these very public, very bitter negotiations between health plans and hospital systems," says William Custer, director of the Center for Health Services Research at Georgia State University's J. Mack Robinson College of Business. And with hospital chains and insurers both consolidating nationally and eager to wield their new market clout, odds are high that the rancorous battles will worsen.

The latest frays between UnitedHealth, the country's second-biggest insurer, and Nashville-based hospital giant HCA Inc.,

may be an ugly portent. Since early September, the two have been at loggerheads in the Denver, South Florida, and Tampa areas, where UnitedHealth's contracts with more than 30 hospitals lapsed after the insurer refused to accept HCA's demand to boost reimbursement rates by 8%, twice the national inflation rate for hospitals. "We stand for affordability," says David S. Wichmann, president of the outfit's UnitedHealthcare unit.

## "MEXICAN STANDOFF"

CERTAINLY NEITHER HCA nor UnitedHealth is endearing itself to doctors. "They are two very powerful, wealthy corporations who are in a Mexican standoff," says Denver gastroenterologist Mark A. Linkow, one of hundreds of doctors who scrambled to get credentials at Denver's St. Joseph Hospital and is seeing some patients there instead of at an HCA site. "The patients and the doctors are very much caught in the middle."

Both sides are playing hardball. HCA ran ads urging patients in Denver to



**IN THE MIDDLE**  
Denver's Dr. Linkow had to change hospitals

switch insurers. UnitedHealth countered with a lawsuit accusing HCA of trying to use its market power to "extort" anticompetitive rates. HCA won the first round

Sept. 21, when a federal judge refused to give UnitedHealth a temporary restraining order. HCA, insisting it wants only "fair reimbursement," has claimed vindication. After days of shunning talks, the parties are back at the bargaining table, though they had no deal at press time.

Insurers generally are under pressure to keep up their margins. Premiums for employer-sponsored coverage are going up by less than in past years—7.7% this year vs. 9.2% last year and a peak of 13.9% in 2003, the Henry J. Kaiser Family Foundation said on Sept. 26. So it's no wonder insurers are putting more pressure on hospitals. Some are tying rates to performance, a thorny topic in WellPoint's dispute last summer with Atlanta's Piedmont hospital chain. "Nobody is guaranteed a rate increase," says WellPoint Chief Financial Officer David C. Colby. Piedmont and WellPoint finally agreed in August on a contract after court action and a pitched newspaper ad battle.

More such disputes are brewing. Transplant patients at Milwaukee's Froedtert Memorial Lutheran Hospital must go elsewhere since a contract with UnitedHealth lapsed on Sept. 1, and the hassle may spread to all UnitedHealth patients there on Nov. 1. UnitedHealth also is trying to hammer out deals with hospitals in Tennessee and Kentucky. A WellPoint could be facing a tough go talks with some Tenet Healthcare Co. hospitals in St. Louis. ■

—With Dean Foust in Atlanta

## Backstory

What may be motivating the two giants:

### HCA

The hospital chain is preparing to take itself private in a \$33 billion LBO. UnitedHealth and others have suggested HCA is hiking reimbursement rates to shore up its finances. HCA denies it.

### UNITEDHEALTH

The big insurer's image has taken a hit amid a federal probe into stock option awards. UnitedHealth says it is refusing to accept HCA's proposed hike because it will hurt consumers.



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## AUTOS

# HOT ASIAN CARS, DESIGNED IN DETROIT

Toyota and others are hiring as Motown fast becomes an engineering mecca

BY DAVID KILEY

**T**HE BRAVNY NEW 2007 Toyota Tundra pickup set to go on sale early next year was being measured, poked, and prodded in mid-September in Dearborn, Mich., right in the shadow of Ford Motor Co.'s world headquarters. The National Truck Equipment Assn. conference was in full swing, and dozens of makers of ladders, tool racks, and utility boxes were preparing to outfit the new trucks for the contractor and builder crowd, a bunch that usually buys Fords, GMs, and Dodges.

The redesigned Tundra, with telescoping rearview mirrors and a center console that holds hanging file folders and a laptop, may be seen as the most worrisome broadside in the Asian onslaught against the U.S. auto industry to date. And it's ammunition for critics who think Detroit is as hopeless as the woeful Detroit Lions. But the truck was mostly designed and engineered not in Japan or even Toyota's California studios, but 35 miles from Ford in the Toyota Technical Center USA Inc. in Ann Arbor, Mich.

So while most of the news these days from the Big Three is bad—multibillion-dollar losses and more than 70,000 jobs about to vaporize—the Detroit-to-Ann Arbor corridor is no industry graveyard. Toyota, Nissan, Hyundai, Kia, Suzuki, and at least one Chinese automaker are all prowling for engineering and design talent around Detroit. And Ford, GM, and Chrysler are paying five-figure retention bonuses to keep their top talent.

The Asian cars and trucks developed and designed within a 40-minute drive of Detroit read like a list of the most hated vehicles in Big Three boardrooms: Toyota Camry, Sienna minivan, and Avalon

**MICHIGAN BORN** sedan; Nissan's Ti sedan; Nissan's Ti sedan; Nissan's Ti sedan. The new Tundra, Altima, and Versa; soon vehicles from Ann Arbor Hyundai and Toyota's E. Chas

“Chuck” Gulash, a former General Motors Corp. engineer who is vice-president of research and materials engineering at Toyota’s Michigan tech center, says several of the company’s vehicles have benefited from being designed around the Motor City and specifically Ann Arbor, “a truly global town, drawing students and engineers from all over the world to the university [of Michigan].” Indeed, version of the Sienna, Tundra, and Avalon designed in Japan didn’t take off until after the Michigan makeovers.

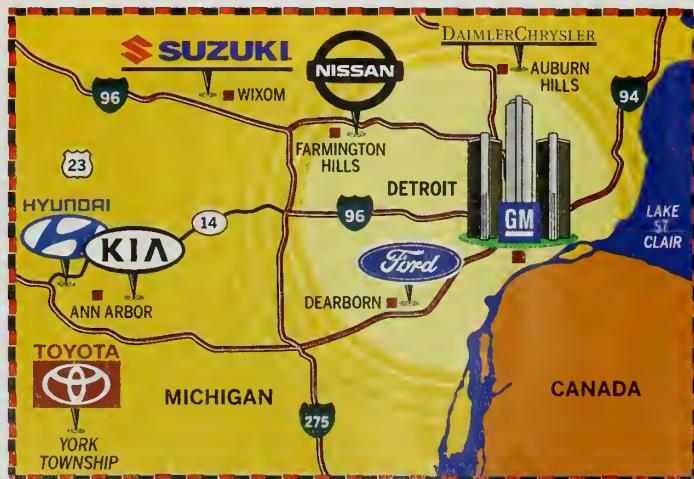
## TALENT CENTRAL

WITHOUT EVER LEAVING the state, local talent has plenty of opportunity at Asian car companies and suppliers. Toyota Motor Corp. employs almost 700 people at a 1-acre campus in Ann Arbor, and it’s building a second facility nearby with room to grow. Hyundai-Kia opened its tech center in Ann Arbor a year ago and so far has about 30 designers and engineers working on vehicles to be built at Alabama and Georgia plants. Nissan already has 1,200 workers, mostly engineers and designers, in near Farmington Hills. And Visionary Vehicle, the venture between entrepreneur Malcolm Bricklin and Chinese automaker Chery Automobile Co., is scouting a tech center around Detroit.

Résumés pour into Hyundai, Toyota, and Nissan, many from employees at the Big Three, say executives, though up to 70% of hires are students who have interned or worked for them part-time. “Tech jobs tied to real intellectual capital in the auto industry have a great future at the Big Three and their competitors as the Asian investment shows,” says

David E. Cole, chairman of the Center for Automotive Research in Ann Arbor.

Jessica Nunn, a senior chemical engineering at University of Michigan, agrees she has a leg up in the job market, having worked briefly for Toyota in materials research. Her skills are in demand at auto companies and petrochemical giants searching for fuels, so she can stay put—or “see some of the world,” says the Detroit native. But the way hiring is going, it looks as if she can’t wait to come home. ■





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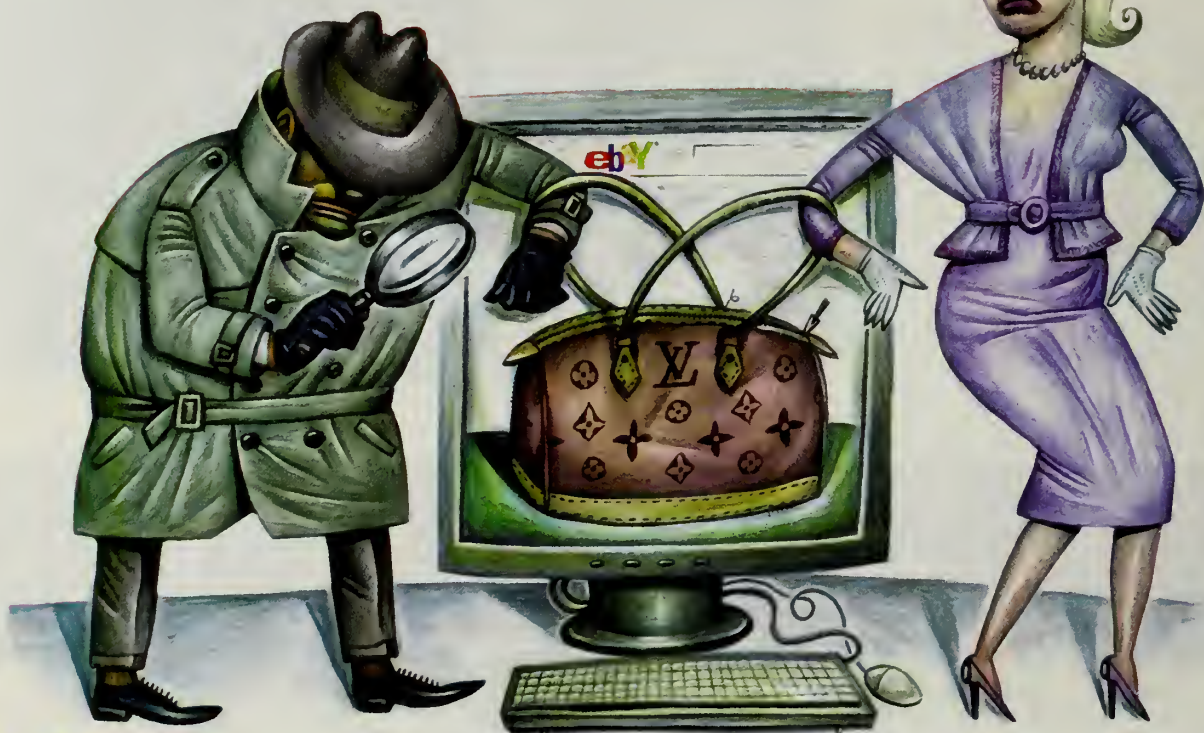
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## COUNTERFEITING

# FED UP WITH FAKES

LMVH and other luxury brands are aiming big guns at online purveyors of knockoffs

BY CAROL MATLACK

**A** RECENT LISTING ON eBay reads: "Brand new authentic Louis Vuitton holdall, \$188!" Offers another: "Authentic Dior sunglasses, \$23.30." Too good to be true? You bet, says Paris-based luxury giant LVMH Moët Hennessy Louis Vuitton. LVMH has filed a lawsuit against eBay Inc. contending that nearly all Vuitton and Dior items sold on the auction site are fakes.

LVMH's complaint, filed in a Paris court on Sept. 21, is the latest salvo in a battle that could shake the foundations of the online auction business. eBay has long styled itself as a marketplace where buyers and sellers make deals with minimal supervision. But companies such as LVMH and Tiffany & Co., which has filed

a similar suit in the U.S., say that eBay has allowed counterfeit trade on its sites to spiral out of control. The companies estimate that fewer than 10% of eBay-listed items bearing their brand names are genuine. eBay says the LVMH suit is "without merit" and that the auctioneer works closely with brand owners to identify and remove offending sellers. Still, "the problem just gets worse," says James Swire, a New York-based lawyer with Arnold & Porter who represents Tiffany. "We take down more [sellers] every year."

LVMH can expect a sympathetic hearing in France, where anti-counterfeiting laws are so tough that sim-

ply owning a fake Vuitton handbag punishable by a fine of twice the value of a genuine bag. A French appeals court last June upheld a lower court decision

## THE STAT

# 90%

Proportion of Louis Vuitton and Christian Dior items listed on eBay that LVMH alleges are fakes

Data: LVMH

ordering Google Inc. to pay nearly \$400,000 in damages to LVMH because its search engine had displayed advertising from merchants selling fake Vuitton goods. Google sued after the ruling that would bar advertisers from buying listings using others' trademarks. Emboldened by that ruling, LVMH now is seeking \$50 million in damages from eBay.

What if LVMH wins? Consolation for eBay is that French courts are stingy awarding damages, so



ne Cousin, a Paris-based litigation specialist with the London law firm Denton Fild Sapte. To win the kind of damages it seeks, LVMH would have to document thousands of individual sales of fake items, Cousin says. Yet even if the award were minimal, a French ruling against eBay could have big consequences. The court could, for example, order eBay to remove fakes from its pages worldwide, not only from its French site, on grounds that France-only fix wouldn't stem the damages suffered by LVMH. "The cost of policing would directly impact eBay's business model," says Thomas Hemnes, an intellectual-property lawyer with the Boston-based GTC Law Group.

## WALKING ON WAL-MART

NO QUESTION, LVMH is willing to fight to protect its gold-plated brands, which include Vuitton, Dior, Fendi, Guerlain, and others. Already this year it has won court cases in China against the popular Silk Market in Beijing, and against the Chinese unit of Paris-based retailer Carrefour, for selling counterfeit handbags. And in June, LVMH sued Wal-Mart Stores Inc. in the U.S., alleging that its Sam's Club stores were carrying fake Fendi bags. Wal-Mart has denied the charge and says it can prove the bags were genuine.

Lawsuits are only part of the threat to eBay's business, though. Experts warn of the spread of knockoffs on the site is hurting legitimate vendors and turning off buyers. "Fraudsters are getting better and better at scamming the system," says a Steiner, editor of AuctionBytes.com, a newsletter for online auction users. "As more people have bad experiences, it's a growing problem."

Fine—but who should fix it? An eBay spokesman says the company monitors the site for counterfeit goods and responds promptly to complaints. But, he says, "a brand owner is the only one that can truly and effectively police its own brand." Says Scott Devitt, who tracks eBay for St. Louis brokerage Stifel, Nicolaus & Co: "In the physical world, it's not a mall owner's responsibility to manage everything a merchant does." Indeed, some earlier efforts to pin blame on eBay have failed. A German court in 2002 rejected a request for Switzerland's Montres Rolex to ban the sale of Rolex-branded watches on eBay. Rolex is appealing the decision to Germany's supreme court.

Yet critics say eBay is clearly losing ground in the fight against counterfeit goods. Test purchases from among roughly 300,000 Dior products and 10,000 Vuitton items offered on eBay

## CHINA

# Take That, You Pirates

China has long been a great place for movie buffs with no qualms about ripping off Hollywood. The sidewalks of Beijing, Shanghai, and other cities are thick with vendors hawking pirated copies of even the most recent studio releases for as little as \$1. That makes it tough for Hollywood to earn money. The big studios say fakes cost them nearly \$2 billion annually across Asia.

Warner Bros. has come up with a novel strategy to fight back. Until last year, the studio sold DVDs of its films in China for

studio won't provide details of its Chinese revenues, Mark Horak, who oversees Asian sales for Warner Home Video Inc., says: "We're seeing significant improvements in our sales performance" due to the change.

Even at \$1.88, though, the real thing is nearly double the price of many knockoffs. So why are Chinese buyers starting to make the switch? The counterfeits—especially of the newest releases—are often filmed with a camcorder in a theater, which makes for lousy sound, a wobbly image, and sometimes even heads popping up in the foreground. Many fakes are higher-quality

copies of DVD releases, but even these lack extras such as interviews with actors. "True movie fans buy the real ones," says 26-year-old Wang Yan as he browses the offerings at the Fab Endless Culture movie shop in Beijing. "The quality and the translations are much better, and the price has come down."

Despite Warner's success, other studios remain skeptical. Unless Beijing cracks down harder on fakes, there's little chance the strategy will make much of a

difference. So, Hollywood isn't backing off more aggressive tactics. The Motion Picture Association of America on Sept. 14 filed suit in Beijing against two local retailers and has won settlements in 10 similar suits over the past three years. In the first half of this year, the MPAA says an operation it calls Red Card has resulted in 405 raids in China and seizures of 1.9 million pirated DVDs.

—By Dexter Roberts and Ronald Grover



**DON'T SHOOT** A camera-shy knockoff vendor

about \$3, and typically released them three or four months after they started showing in American cinemas. In April, though, Warner slashed prices nearly in half, to about \$1.88. Perhaps more important, they're now available within days of their release in theaters—earlier than anywhere else in the world. *Superman Returns*, for instance, has been in Beijing stores for some time now, but still isn't available on DVD in the U.S. Although the

during the first six months of this year showed that 90% were fakes, LVMH says. The "brand new" Vuitton holdall listed for \$188, for example, is certainly going cheap since the genuine article retails for \$885 and is sold only at Vuitton boutiques and a handful of high-end retailers such as Neiman Marcus. "It's not enough for eBay to say, 'Tell us there's a counterfeit.' eBay knows, or should know" without being told, says Louis S. Ederer, an intellectual property lawyer at New York firm Torrys LLP who has successfully represented Tommy Hilfiger Corp. and others in counterfeiting cases against retailers.

For now, it's caveat emptor for eBay shoppers. Helena Amourdedieu, a Paris public-relations consultant, says that she paid nearly \$500 last winter for what she discovered was a fake Chloé "Paddington" handbag on eBay. The seller ignored several demands for a refund, finally relenting after she posted a negative review on eBay's site. But, Amourdedieu vows, "I'll never again buy anything expensive on eBay where there's a brand label involved." If more customers follow her example, eBay could have a genuine problem on its hands. ■

—With Tim Mullaney in New York





## WINE MAKING

# POTATIONS FROM CHAIRMAN MAO

Can China produce fine wines?  
There's big money betting that it can

BY FREDERIK BALFOUR

**I**F SHANXI PROVINCE EVER MAKES the news, it's usually because of a tragedy at one of its thousands of coal mines, or perhaps the pollution from the power plants they fuel. But Chan Cheung Keung wants to put Shanxi on the map for another reason: its wine. The Hong Kong-based entrepreneur has built a \$5 million winery in the village of Dongjia, 30 miles from Taiyuan, Shanxi's capital. His Grace Vineyard château is surrounded by vines heavy with grapes ripening in the autumn sun, nearly ready for his Italian presses and fermentation tanks and oak barrels imported from California, France, and Hungary. "It's my dream to introduce good wine into China," says Chan, who made a small profit last year on the half-million bottles he produced.

Wine making in China's coal belt? Well, Shanxi is on the same latitude as France's Bordeaux region. It has a similar climate, and its soil mix of silty loam and small amounts of clay make it ideal for growing cabernet sauvignon, Chardon-

nay, and merlot grapes. Although China has little tradition of wine drinking—locals prefer a fiery grain-based spirit called *baijiu*—consumption is picking up. While the rest of the global wine market is stuck in the doldrums, China's has grown by an average of 11% annually for the past five years, to 410 million liters in 2005, estimates London wine consultancy International Wine & Spirit Record.

China's tipplers are an abstemious bunch compared with their Western counterparts. Per capita wine consumption works out to about two glasses per year, while Americans drink some seven liters each annually, and the French quaff 55 liters apiece. "There is gigantic potential for development," says Robert Luc, a board member for Dynasty Fine Wines Group Ltd., China's No. 2 producer, which aims to ramp up its production

**THE EAST IS REDS**  
At Grace Vineyard, stoking a thirst for merlot

from some 38 million liters last year to 80 million in 2010.

The budding market has winemakers from around world putting down roots. All told, China now has more than 100 vineyards, including many associated with some of the biggest names in the business. Paris-based Rémy Cointreau has a 26% stake in Dynasty, based in the coastal city Tianjin. Austrian crystal group Swarovski has spent \$30 million building Bodega Langes Co. winery in central Hebei province. France's Castel Group has a joint venture with China's largest winery, Yantai Changyu Pioneer Winery Co., based in coastal Shandong Province. Robert Mondavi Group imports California wine in bulk for bottling under its label in Beijing.

## MYSTERY LABELS

CHINESE VINEYARDS can make surprisingly good wine. Grace's \$10-a-bottle Chardonnay has melon and baked apple flavors, and its \$80 Chairman's Reserve—a blend of cabernet sauvignon, merlot, and cabernet franc—is complex enough to rival many top-quality Bordeaux. While the overall quality of Chinese vintages is still mixed, "some wineries are making agreeable wines that are good to drink and taste like very real Bordeaux," says Lau Chi Sun, editor of Hong Kong-based *Wine Now Monthly* and an occasional consultant to Grace.

One concern is that China lacks a formal system of control of origin like those in France and Italy. That means drinkers have no way of knowing whether a bottle actually comes from Shanxi or Hebei province—or someplace

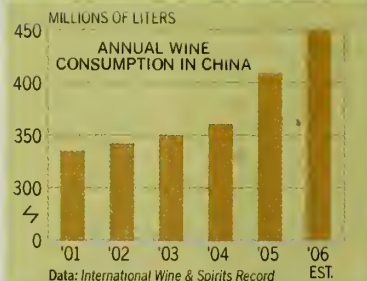
much farther afield, regardless of what the label says. In fact, many wineries import bulk wine from Chile, Spain, or Argentina, paying as little as \$1 a liter, then slap a Chinese label on it.

Even as vineyard work hard to boost quality and educate Chinese drinkers, it may be some time

before mainland vintages start clinching prizes in international tastings. While China has developed other industries at warp speed, there's no way to hurry newly planted vines into maturity. ■

—With Carol Matlack in Pe

## SOUSING THE DRAGON

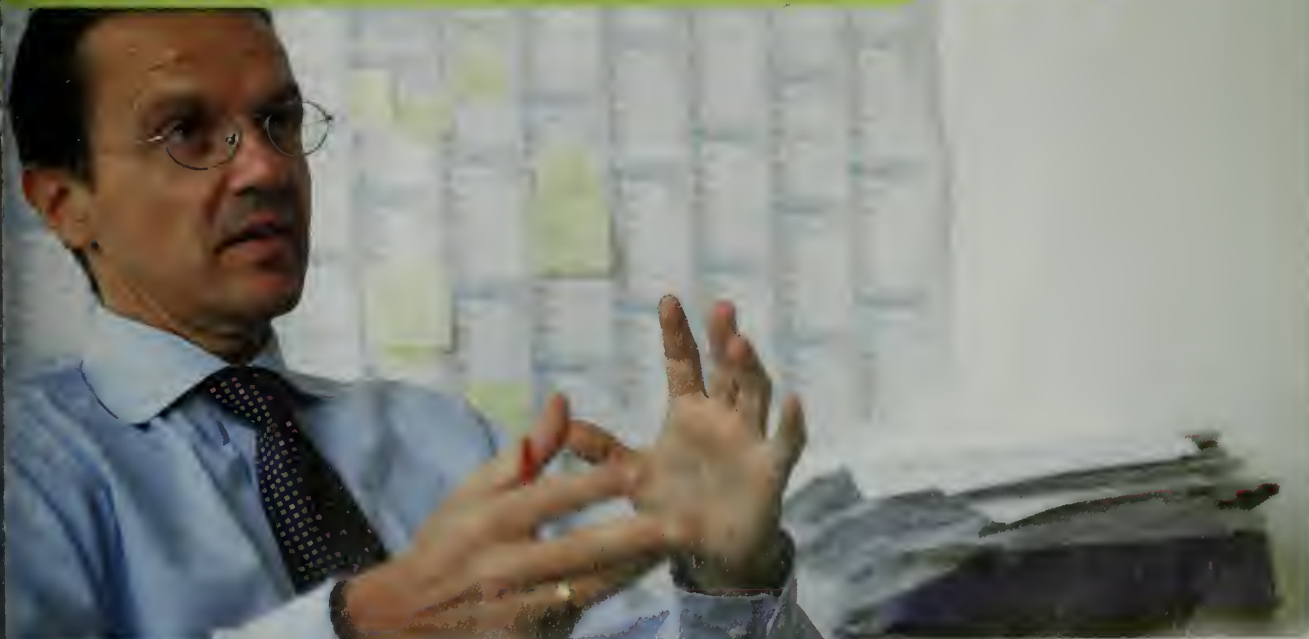


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## REAL ESTATE

# THE RUSSIAN TOWERS ARE COMING

Foreign investors are getting in on projects from Moscow to Novosibirsk

BY JASON BUSH

**N**OT TOO MANY YEARS ago, Moscow's skyline consisted of little more than the onion domes of the Kremlin and the Gothic spires of the Stalin-era buildings known as the Seven Sisters. But today, a forest of cranes dominates a 250-acre stretch along the Moscow River, where the 93-story Federation Tower—soon to be Europe's tallest—is rising. A few blocks away, the European Trade Center, with 160 stores, a nine-screen cinema, and a swimming pool, is nearing completion. And on the city's outskirts, the 54-story Triumph Palace last year began offering luxury residences to wealthy Russians. All across Moscow, new office towers and apartment blocks are transforming Russia's capital.

While much of the boom is due to oil money, overseas investors are getting in on the action, too. This year, foreign investment funds are likely to sock as much as \$1.5 billion into Russian real estate projects, nearly double last year's level, according to real estate consultant CB Richard Ellis Noble Gibbons. "Russia is clearly a key market for us," says John Carrafiell, global co-head of Morgan Stanley Real Estate, which in July bought 10% of developer RosEuroDevelopment. The Russian group plans investments worth \$3 billion over the next five years, including office towers and shopping malls in major regional cities, and a \$500 million campus for high-tech firms in the Siberian city of Novosibirsk.

The attraction? Booming business and rising personal wealth mean that demand is up for all types of property. Top-quality office space in Moscow now rents for \$95 a square foot—two-thirds higher than in Midtown Manhattan. That's bad news for Moscow's business tenants, but it's a



Foreign funds are likely to invest **\$1.5 billion** in Russian property this year

boon for real estate investors, who are seeing annual returns that top 10%, vs. 4% to 5% in Western Europe and the U.S.

Morgan Stanley isn't alone in trying to cash in on the growth. Austria's Meinel European Land Ltd. in March paid \$508 million for four Moscow hypermarkets. British fund Raven Russia Ltd. raised \$266 million for Russian real estate last year. And London-based Fleming Family & Partners three years ago launched a

\$60 million Russian real estate investment fund with money from U.S. investors such as the General Electric Pension Trust. Now the group is raising a second fund, worth at least \$150 million and hopes to invest \$1 billion in the country over the next two years. Russia "gives a substantial upside compared to West Europe," says Nikolai Karetnikov, Fleming's asset manager in Moscow.

One problem, though, is finding projects that meet Western standards. Investors remain concerned about the quality of Russian construction and the reliability of partners. Until recently, foreign investment funds put money into completed buildings only, steering clear of

risks connected with construction and development—a murky business in Russia. Construction projects typically require more than 300 separate permits and licenses. It's a red-tape barrier that opens big possibilities for corruption.

But as property prices and bargain grow, some investors are starting to take on greater risks for higher returns. They

are now keen to fund construction where annual returns of at least 20% are the norm. They're also getting smaller cities such as Novosibirsk, Ekaterinburg, Krasnoyarsk, which are largely virgin territory. "The Russian region are now much more attractive to investors than Moscow," says

Valentina Korotayeva, commercial director at RosEuroDevelopment. "You can still buy a very good site and build a very good project at low cost."

Indeed, as Moscow real estate prices continue their ascent, there are growing fears that the market will overshoot. Russia's reliance on volatile oil heightens the chance of unexpected shocks. But analysts play down the risk of a commercial real estate bubble. Demand continues to be supplied by a wide margin, says Elena Florova, head of research at CBRE in Moscow. While Paris and London have 300 million to 400 million square feet of modern office space, more populous Moscow has just over 50 million. Much of it Soviet-era construction lacks air conditioning, sophisticated communications, and sufficient space for parking. Says Florova: "We don't think we will have any crisis soon." ■





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about how changing  
applications could  
dramatically speed  
up product design.

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server overheated  
and he spent the day  
shopping for fans.

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# The Talent

**DESPERATE TO INNOVATE, COMPANIES ARE TURNING**

(L TO R) PHOTOGRAPHS BY ROGER MASTROIANNI; PETER SCHINZLER; BRIAN SMALE; ROBBIE MCCLARAN



**DAN LI**

“In China, we have a lot of engineers and a lot of designers, but they don’t really work together. We don’t talk as much about the idea of design management.”

—Dan Li (“Grace”) is a 2004 engineering grad of Beihang University in Beijing. Now she is a design grad student at the University of Cincinnati and a research assistant in P&G’s innovation division.



**MARTIN MANGOLD**

“The combination of business and design gives you different solutions than if you only had a classical financial perspective on a problem.”

—Martin Mangold graduated in 2006 from the Zollverein School of Management & Design (Essen, Germany). Today he is a senior manager for marketing, design, and strategy at H.P. Pelzer.

# Hunt

## DESIGN SCHOOLS FOR NIMBLE, CREATIVE THINKERS



IAN LIO

learned how to speak with customers, designers, engineers, marketers, salespeople. I understand their different perspectives. ”

graduated from Rochester Institute of Technology and its new program for Innovation & Entrepreneurship in 2006. He works at Intel as a product manager in mobile and embedded devices.



JANNA KIMEL

“ My interest was piqued by this left-brain/right-brain combination. You get to be creative, but you have to do it logically. ”

—Kimel is a 2005 Georgia Tech industrial design grad. She's a design researcher in the Digital Health Group at Intel.



## By Jessi Hempel and Aili McConnon

**T**ECH GEEKS LOVE MOZILLA'S FIREFOX BROWSER, which is impervious to most viruses, but mainstream America has yet to embrace it. How does Mozilla move beyond invention (cool browser, neat functions) to an innovation that translates into market success (a Net tool so hot it upends Microsoft's Corp.'s Explorer)? ¶ It's a perfect problem for a classroom case study. So last spring, Mozilla's business development team turned to Stanford University. But instead of going to the business school, they headed for the double-wide trailer that housed Stanford's Hasso Plattner Institute of Design, dubbed the "D-school" on campus. The

course was team-taught by Stanford profs and industry professionals. Each student worked in a team that included a B-schooler, a computer science major, and a product designer. And each team used design thinking to shape a business plan for Mozilla.

It made a big difference. A B-school class would have started with a focus on market size and used financial analysis to understand it. This D-school class began with consumers and used ethnography, the latest management tool, to learn about them. Business school students would have developed a single new product to sell. The D-schoolers aimed at creating a prototype with possible features that might appeal to consumers. B-school students would have stopped when they completed the first good product idea. The D-schoolers went back again and again to come up with a panoply of possible winners.

### TROUNCING TRADITION

ONE IDEA WAS Firefoxies.com, a social networking site where users submit photographs and vote on the quality of friends' photos. The catch: You have to download Firefox to vote. So far, 30% of the site's visitors have done so. Among marketers, that's huge.

The power of this new approach, called design thinking, to promote innovation and open up business opportunities is attracting the attention of corporations around the globe. Design has evolved from a narrow discipline dealing with the form and function of products

into a major new approach to developing business models.

As business increasingly turns to India and China to provide low-cost, high-quality goods and services, companies have to focus on innovation to be competitive. That driving need makes design thinking the hottest trend in business culture today. If engineering, control, and technology were once the central tenets of business culture, then anthropology, creativity, and an obsession with consumers' unmet needs will inform the future.

This change in focus is leading to a huge corporate talent hunt. To make their business culture more innovative, managers are hiring thousands of new people who can think and act more creatively. More and more, recruiters ask if people with a degree in "administration" are up to the task.

That's why such corporations such as Nike, General Electric, McDonald's, Intel, and many others are looking beyond traditional sources of leadership to a new set of schools and programs to find innovative managers. And that's why Stanford's D-school has earned a place on our inaugural list of Top D-schools, the first-ever survey of design schools and design programs in the U.S., Europe, and Asia that are graduating the innovators companies hunger for. These are the schools that "move away from analyzing existing options and look to the creation of new options that have not yet been considered," explains Roger Martin. He's dean of the Rotman School of Management at the University of Toronto, a leading school in design thinking.

**Design schools seek "new opportunities that have not yet been considered"**

## The Top Design

### NAME

Arizona State University, College of Design

Art Center College of Design

California College of the Arts

Carnegie Mellon University, School of Design

Case Western's Weatherhead School of Management

The Cleveland Institute of Art

College of Creative Studies

Cooper Union

Georgetown's McDonough School of Business

Georgia Tech College of Architecture

Harvard Business School

Harvey Mudd College

Illinois Institute of Technology Institute of Design

Massachusetts College of Art

MIT Media Lab

MIT Sloan School of Business

NC State College of Management

Northwestern University, Kellogg School of Management

NYU's Interactive Telecommunications Program

Olin College of Engineering

Parsons, The New School

Pratt Institute

Rhode Island School of Design

Ringling School of Art & Design

Rochester Institute of Technology

Stanford's Hasso Plattner Institute of Design

Syracuse University, School of Art & Design

U.C. Berkeley's Haas School of Business

University of Cincinnati College of D.A.A.P.

University of Illinois, Urbana-Champaign

University of Michigan, Ross Business School

University of Pennsylvania, Wharton School

University of Toronto, Rotman School of Management

U.S.C.'s School of Television & Cinema



|        | DESIGN-RELATED ACADEMIC PARTNERSHIPS                                                            | COMMENTS                                                                                                                                                                                                                        |
|--------|-------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Ariz.  | Business school and engineering school within Arizona State                                     | At InnovationSpace, a transdisciplinary studio, undergrads create new business ventures for companies like Intel and Herman Miller; aiming for 2008 launch of graduate version.                                                 |
| Calif. | INSEAD, Tama Art University                                                                     | Students work in transdisciplinary studios on products, business ideas, and strategies for companies like DaimlerChrysler, Hewlett-Packard, Honda, and Disney.                                                                  |
| Calif. | U.C. Berkeley's Haas School of Business                                                         | Recently partnered with Korean cell-phone manufacturer Pantech to build prototypes with CCA students and 20 Korean students.                                                                                                    |
| Conn.  | English Dept.; Mechanical Engineering Dept.; Human-Computer Interaction Institute; B-school     | Hosted Emergence, a service design conference, in September, 2006. Course sponsors include Intel, New Balance, and Ford. Award-winning Integrated Product Development Course.                                                   |
| Ill.   | The Cleveland Institute of Art; Technical University of Eindhoven                               | Held 2002 "Managing as Designing" workshop applying Frank Gehry's design approach to management decisions. Turned workshop into DVD and book. Information Design and Management Course mandatory for all students.              |
| Ill.   | Case Western's Weatherhead School of Management                                                 | Industrial Design chair Daniel Cuffaro has revamped curriculum to include business and plans to bring design to Cleveland city planning.                                                                                        |
| Ill.   | University of Michigan, Ann Arbor; Dearborn and Walsh College                                   | Feeder for major auto companies like GM, Ford, DaimlerChrysler, and Toyota. Plans to open a graduate school in 2008 and has recently added more business to undergrad curriculum.                                               |
| Ill.   | Architecture classes open to engineers                                                          | Employs a fine arts faculty, in addition to architecture and engineering.                                                                                                                                                       |
| Ill.   | None                                                                                            | Developing New Products and Services has been taught for five years by Jeneanne Rae, president of Peer Insight, a service innovation consultancy; brings together business, engineering, and liberal arts students.             |
| Ill.   | Rapid Prototyping & Manufacturing Institute at Georgia Tech; Hong Kong Polytechnic              | Industrial design students work with management, computing, engineering, manufacturing, and marketing students on projects for Coca-Cola, Kodak, Dell, and Xerox.                                                               |
| Mass.  | None                                                                                            | Professor Stefan Thomke leads courses on innovation and operations management that fold in experience design.                                                                                                                   |
| Mass.  | Claremont College consortium                                                                    | The Harvey Mudd College Clinic pairs students with companies from Boeing to Google for projects. Interdisciplinary Center for Design Education for engineering design teachers, researchers, and practitioners.                 |
| Mass.  | IIT's Stuart Graduate School of Business                                                        | Started offering dual MDes/MBA degrees in 2006; hosts workshops for managers and executives to examine how business can use design to solve problems and analyse emerging opportunities and markets; Patrick Whitney, director. |
| Mass.  | Northeastern's entrepreneurial program; Bentley College (both in 2007)                          | Companies such as Bose, Reebok, and Dunkin' Donuts have sponsored projects in the industrial design development lab.                                                                                                            |
| Mass.  | Other departments within MIT                                                                    | An applied research laboratory where businesses sponsor student research in arts, science, and technology.                                                                                                                      |
| Mass.  | Rhode Island School of Design                                                                   | Unlike many other B-school programs, students have the freedom to branch out into other MIT departments, such as MIT Media Lab.                                                                                                 |
| Mass.  | College of Design and engineering departments at North Carolina State University                | Business students, industrial designers, and engineers tackle product and service design for IBM and others in the integrated new product development lab.                                                                      |
| Mass.  | McCormick School of Engineering; discussing partnerships with The Art Institute of Chicago      | Offers dual MBA and Masters of Engineering Management degrees.                                                                                                                                                                  |
| Mass.  | Various                                                                                         | Unites dancers, computer scientists, and financiers to push the frontiers of interactive media under direction of Red Burns.                                                                                                    |
| Mass.  | Babson College; Wellesley College and Brandeis University                                       | Engineering education focuses on a triangular approach that includes business, fine arts, and science.                                                                                                                          |
| Mass.  | Columbia Business School                                                                        | Companies like Samsung, Siemens, and Target provide design challenges for new product lines and processes. Leader in fashion design.                                                                                            |
| N.Y.   | Delaware College of Art & Design                                                                | Offers Master of Professional Studies in Design Management for executives.                                                                                                                                                      |
| N.Y.   | MIT Sloan School of Business; Brown University School of Engineering                            | Feeder for Martha Stewart Living; undergrads travel to Cambridge to work in teams with Sloan students; they also build prototypes with Brown engineering students.                                                              |
| Fla.   | Various art and design programs                                                                 | Hosting international summit in October, 2006, on the role of design in the global economy.                                                                                                                                     |
| N.Y.   | Program for Innovation & Entrepreneurship (PIE)                                                 | PIE combines business, technology, and art and design students.                                                                                                                                                                 |
| Calif. | B-school; Engineering, et al.                                                                   | A new design institute of graduate education that offers interdisciplinary programs that include one course each semester. Students completing three courses earn a certificate; David Kelley, co-founder.                      |
| N.Y.   | Various departments within university                                                           | One of the oldest industrial design programs in the U.S. Changed program name to include "Industrial and Interaction Design" to address service design in addition to product design.                                           |
| Calif. | Berkeley College of Engineering; Berkeley School of Information; California College of the Arts | Starting mini two-day design thinking workshops for business school students in fall, 2006. Managing the New Product Development Process class has combined business, engineering, and arts students for eight years.           |
| Calif. | Various                                                                                         | Nationally ranked co-op program in which design students graduate with about 18 months of paid professional experience.                                                                                                         |
| Calif. | College of Business; Tech & Entrepreneur Center (TEC)                                           | The TEC offers certificate programs for professional development, as well as an annual business plan competition and a student prize for innovation.                                                                            |
| Mich.  | University of Michigan College of Engineering                                                   | The Integrated Product Development course combines students from business, engineering, and art and design.                                                                                                                     |
| Mich.  | Engineering School; Design School                                                               | A new interdisciplinary program between Wharton, the school of engineering, and the school of design; a special program for top executives on design took place in Copenhagen and Milan.                                        |
| Mich.  | University of Toronto's Engineering Dept.; Ontario College of Art & Design                      | Rotman added a second design course to the curriculum in fall of 2006. Started offering executive workshops in 2006. Roger Martin is the dean.                                                                                  |
| Mich.  | Tokyo Institute of Technology                                                                   | Partners with Hewlett-Packard and Sony; new interactive media program combines technical skills, storytelling, and business, bringing together communications, engineering, fine arts, and game design students.                |





We are also presenting individual stories of success in this talent hunt. These include a graduate of the Illinois Institute of Technology's (IIT) Institute of Design in Chicago who is working as senior director of innovation advanced concepts at McDonald's Corp. A graduate from Carnegie Mellon University is a design researcher at the Mayo Clinic's SPARC Innovation Program. A graduate of INSEAD's product development course with Art Center College of Design students is a member of GE's Experienced Commercial Leadership Program. Northwestern and Germany's Zollverein School of Management & Design grads are leading marketing teams at Johnson & Johnson and H.P. Pelzer Group. A grad from Massachusetts College of Art is the director of global design resources for the Gillette Co. worldwide.

## HYBRID GRADS

WHAT CHARACTERIZES the best D-schools and design programs? First, they are multidisciplinary. They combine engineering, business, design, and social sciences. They team-teach using groups of professors and outside professionals. And they teach students who are organized in groups to operate as teams.

Second, they can be found in both D-schools and B-schools, plus the growing number of joint ventures between the two. B-schools are adding design course tracks. Engineering schools are opening innovation centers. Classical design schools are adding business components.

Third, D-school grads are special. Call them hybrids or polymaths, they are people with both extraordinary depth in a field and the breadth of knowledge to apply it. "A lot of companies have multidisciplinary teams—marketing people, engineers, designers, strategists. But having all those parts embedded in one person's brain—that really puts you over the edge

AS TOLD TO JESSI HEMPEL

# INSIDE THE VOLCANO

**AT CARNEGIE MELLON,** I took a first year seminar with Dick Buchanan. He used to liken [design thinking] to climbing into a volcano: It's messy and it's risky and it's dangerous. To tap into unique insights, you have to follow tangents and lose yourself in them. The trick was to learn when and how to climb out of the

volcano. People from all disciplines want to tackle complex problems. Designers can make something that allows a much richer conversation about the problem you want to solve.

At Mayo Clinic's SPARC Innovation Program, our program space is right in the middle of the clinical space. There are patients across the hallway. The conversation that happens in the doctors' offices is so loaded with history that allowing [patients] to have an equal conversation is incredibly hard. Our challenge was, can we change that conversation that patients and physicians are having?

Our director of research is an endocrinologist and does work with people with type 2 diabetes. We decided to investigate: How do we help them make better decisions about their medications? When we first started, I didn't know anything about diabetes. He explained it, and I made a card up for each of the five medications, like baseball cards. We gave them out to patients. They were

intrigued, but it didn't really change the conversation at all.

People wanted to be able to make comparisons. So we divided issues into categories—side effects, weight issues, daily routine. We cut them up and created a matrix: medication across the top and across the left side, different issues. We tried this. We gave patients the issues and asked them to order them. We attached them with Velcro. As they would talk about each medication, the physician would lay out categories. In this version, we noticed the patient would talk more.

The form of this prototype we tried was all wrong. There was too much text. It would be hard to work in the exam room. We went back to the card idea, but now the cards were about the issues. The physician would say, "Which is more important to you?" As the patient and doctor spoke, the patient would take more and more of the cards. You would hear patients begin to make their own plans. That was what we wanted.

## Maggie Breslin

**Education** BS from Miami University in Oxford, Ohio, in mass communications, film, and television, 1994; Master of Design, Interaction Design, Carnegie Mellon, 2004.

**Job** Designer/Researcher, The SPARC Innovation Program at Mayo Clinic, Rochester, Minn.



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AS TOLD TO JESSI HEMPEL

## WHEN MBA MEETS DESIGNER

**I TOOK MANUEL SOSA'S CLASS** at INSEAD in the spring of 2005. It was called Strategy for Product and Service Development. An interesting aspect was bringing in design students from the Art Center in Pasadena—it was a new experiment. I was interested in finding out about team dynamics when you put a creative person

in the midst of things.

My perception about designers was, "Here's my product, make it look sexy. Put in the round holes and the right colors and make it look like an iPod." To me, designers came a bit later in the product development cycle.

At the start of the class we had to decide what to work on. Each of

us had a minute to pitch an idea to develop. You could see the difference. MBA pitches dwelt on the market: how big it was, how little it had been served. Most designers said: "Here is how I use the product today. Here is why it sucks and how it can be better. Here's how I want to do it."

Now I'm part of the Experienced Commercial Leadership Program, a two-year program of six-month assignments. I'm on my third assignment. Has the course helped me? Definitely, from a group

### Sameer Agrawal

**Education** Engineering degree from Victoria Jubilee Technical Institute in Bombay, 1997; MBA, INSEAD, Fontainebleau, France, 2005.

**Job** Strategic marketing manager, member of Experienced Commercial Leadership Program, GE.

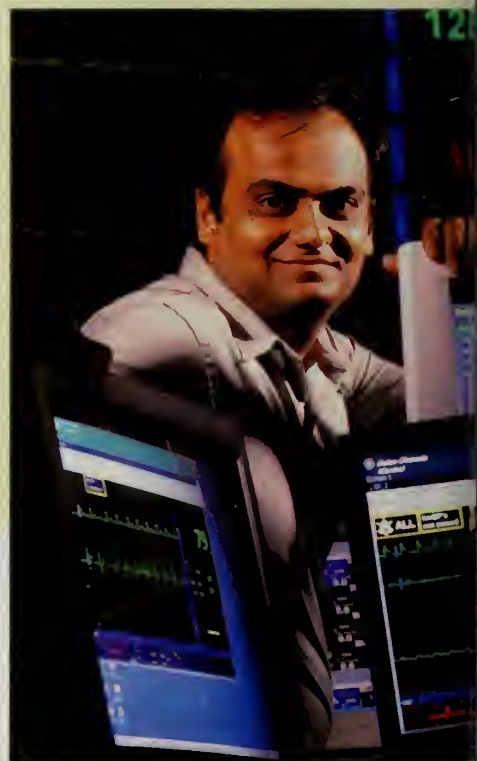
dynamics perspective. It helped me also with the "whole product concept." There is the product you are contractually obligated to deliver, but there are also the elements that go beyond the product to help the customer.

What you do with

the product is as important as what it does. To me, that was the upshot of the experience. You can apply it anywhere.

At GE, I've seen that what the user does with your product is as important as, if not more important than, what the product does itself. Aviation sells different products for an airplane. One thing we sell is an engine. There's a multibillion-dollar business for private jets. [As part of my second six-month

stint,] we were designing the service option of an engine. We said, how do people use this product? One thing became clear: The person receiving the plane as a gift [for personal use] is out there having fun with it, and he doesn't care as long as it meets FAA regulations and it's available when he wants it. The guy who is using it for revenue-generating options, say, an air taxi, will have much different needs, like making sure costs are under control. We can design new services, like the managing of airline logs, vs doing just the traditional services of managing the engine for the managing-the-engine guy. If we didn't understand those different needs, we'd be leaving money on the table. I see design as a philosophy that people learn in order to understand how products are used...all those aspects of the customer experience.



in terms of being able to innovate," says Colleen Murray, an IIT Institute of Design graduate at innovation strategy firm Jump Associates.

To gather our list, we created a 24-person advisory board. They include people from corporations such as Whirlpool, Siemens, and BMW who hire the new design thinking talent; faculty at both D-schools and B-schools such as Art Center, IIT, Northwestern, and Stanford; recruiters such as RitaSue Siegel; and design and innovation consultants such as Yves Béhar at fuseproject and Tamara Giltsoff at London-based Live/Work. They recommended programs from which they hire and where they referred students. We then conducted 200-plus interviews to narrow our picks to the best 60 global programs.

Our list is eclectic. It includes IIT's Institute of Design, a pioneer in fusing de-

sign and business. Its graduates have gone on to jobs in strategy and marketing in Microsoft, Condé Nast Publications, Google, and Motorola. IIT began awarding dual MBA and master of design degrees in 2006.

### JOINT EFFORTS

FORWARD-THINKING business schools on the list, such as Rotman and the McDonough School of Business at Georgetown University, have coursework championed by leading design thinkers such as Roger Martin and Jeneanne Rae. In fact, Martin, IIT's Patrick Whitney, and David Kelley, co-founder of IDEO and Stanford's D-school, have joined together on a project with Claudia Kotchka, the innovation champion for Procter & Gamble Co. The four created a three-day program teaching design thinking's

three components to the hairstylists' products group: deep consumer understanding, the ability to test product variations rapidly, and business strategy formulation. This research laid groundwork for executive workshop summer academy, and a new design elective at Rotman this fall.

Partnerships between D-schools and B-schools are becoming increasingly common. In 2006, for example, France's INSEAD and Art Center in Pasadena, Calif., embarked on a partnership that brings design students to Fontaine-

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bleau, just south of Paris, for a product development class. Students worked in teams to pitch and develop business ideas. The class is oversubscribed, and INSEAD will soon launch the partnership in Singapore.

Much of the impetus to work across disciplines comes directly from businesses. GE Healthcare is currently sponsoring a class at Art Center to develop inexpensive mobile diagnostic imaging devices for India, Africa, and China. Eastman Kodak Co. has gone to Georgia Tech to match industrial designers with students of management and human-computer interaction for projects that focus on photography. Why? Because that's how corporate teams innovate. Sponsoring such a project lets the company motivate students to think in this way and gives it a head start in snapping up tomorrow's superstars.

## TRANSLATORS NEEDED

INTEL CORP. IS spending \$30,000 on student teams at Arizona State's InnovationSpace program, uniting undergraduates from B-school, engineering, and industrial and visual communication design programs to work on new products for aging baby boomers' future homes. The students will spend time hanging out with elderly folks as they cook, sink into living room lounge chairs, and brush their teeth. They'll develop prototypes for new products and related services. And they'll have their subjects try them out, fixing and adjusting quickly to hit a perfect formula. By year's end, each team will develop a proposal for a new business venture. Professors from all four disciplines will teach the class, which is led by noted design professor Prasad Boradkar.

Intel is making big financial bets that design school programs like those at ASU, Carnegie Mellon, and Georgia Tech will provide fresh ideas. Intel made its name as an engineering company in high tech, says Jay Lundell, Intel's director of user experience design in health research innovations. But, he adds, "there's an increasing realiza-

## The Top European & Asian Design Programs

| NAME                                                    | PLACE                           |
|---------------------------------------------------------|---------------------------------|
| Bocconi University                                      | Milan                           |
| Central Saint Martins College of Art & Design           | London                          |
| Delft University of Technology Design Institute         | Delft, The Netherlands          |
| Design Academy Eindhoven                                | Eindhoven, The Netherlands      |
| Domus Academy                                           | Milan                           |
| FH Joanneum University of Applied Sciences              | Graz, Austria                   |
| HKU Utrecht School of the Arts                          | Utrecht, The Netherlands        |
| Hongik University School of Design                      | Seoul                           |
| Hong Kong Polytechnic                                   | Hong Kong                       |
| Hunan University School of Design                       | Changsha, Hunan Province, China |
| Indian Institute of Technology Industrial Design Center | Bombay                          |
| International Design Business Mgmt. Program (IDBM)      | Helsinki                        |
| Köln International School of Design                     | Cologne, Germany                |
| Korea Advanced Inst. of Science & Technology (KAIST)    | Daejeon, Korea                  |
| Kyoto Institute of Technology                           | Kyoto, Japan                    |
| National Institute of Design                            | Ahmedabad, India                |
| Northumbria University Design School                    | Newcastle, England              |
| Polytechnic University of Milan Design School           | Milan                           |
| Royal College of Art                                    | London                          |
| Tama Art University                                     | Tokyo                           |
| Tongji University School of Design                      | Shanghai                        |
| Tsinghua University Academy of Arts & Design            | Beijing                         |
| UMEÄ Institute of Design                                | Umeå, Sweden                    |
| University of Art & Design Lausanne                     | Lausanne, Switzerland           |
| University of Oxford Said School of Business            | Oxford, England                 |
| Zollverein School of Management & Design                | Essen, Germany                  |

tion that to be successful as a technology company, you need the people who can do that translation from engineering to users' needs and back again."

*BusinessWeek's* Top D-schools include European and Asian programs as well. British corporations are leaders in using design thinking, and they hire graduates from the Royal College of Art and Northumbria University Design School. The new Zollverein School of Management & Design in Essen, which opened its doors to executive students in 2005 and

full-time students in 2006, is the buzz of the Continent. Meanwhile, the Chinese government has listed innovation as a national five-year priority and is putting \$15 billion to promote it. There are some 400 design schools in China graduating thousands of students. Most focus on traditional industrial and graphic design, a few, such as Tsinghua University in Beijing, are starting to teach design thinking. And in Korea, D-school students are partnering with their U.S. counterparts.

D-schools are racing to meet the demand for new innovative talent. Some are doing a good job. Others are not. We'll report back to us. ■

## D-schools by Design

**Top Global D-schools:** An extended interactive table.

**The Rise of Asian D-schools:** As China focuses on innovation, programs pop up across the mainland.

**Inside Stories:** Intel's Janna Kimel and J&J's Justine Dube Donnelly tell their personal stories.

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# How Yahoo! Gave Itself a Face-lift

Its redesigned home page is based on data from users' clicks, not its hunches

BY JUSTIN HIBBARD

**W**HEN YAHOO! INC. embarked on a mammoth redesign of its front page last year, almost every department at the company suddenly had an opinion. Naturally, conflicts arose. "Sales would want the ad front and center, and the Yahoo Mail person would say: 'That could potentially cannibalize my business,'" recalls Tapan Bhat, Yahoo's vice-president for front doors, who oversaw the project.

To avoid design by committee, Yahoo deferred almost every decision to an impartial judge: data generated by users' clicks. "We have this culture of data,"

Bhat explains. "It is the biggest enforcer of honesty." If sales wanted an ad smack dab in the front page's prime real estate, the company would whip up a page to those specifications, serve it to actual users, and record their clicks. If traffic increased, great. If not, it was back to the drawing board. The refreshed home page went live in September. Now, with a multimillion-dollar ad campaign to promote the redesign under way, the company is keen to see whether it has truly created a page based on what users like rather than what Yahoo wants.

Getting the home page right is crucial for a portal like Yahoo, especially since the company's advertising revenue has been slowing. Yahoo announced on Sept.

20 that third-quarter gross profit was probably be in the bottom half of forecast of \$925 million to \$1 billion, representing year-over-year growth of 1 to 20%. That's slower than the last 10 quarters by one-third to one-half.

"The Yahoo home page is a very important driver of revenue," notes Jan Friedland, an analyst at New York investment bank Cowen & Co. He estimates that 40% to 45% of Yahoo's \$4.7 billion in annual sales comes from displays such as banners, which appear on pages that users often reach through the front page. Says Bhat: "Any link on the front page has huge ripple effects all throughout Yahoo, and it affects our revenue."

Yahoo made a commitment to harnessing its trove of user clicks in 2004 when it acquired DMX Group, a data mining

consultancy founded by former Microsoft Corp. researchers. Now called Strategic Data Solutions (SDS), the department has a daunting task: coring through the 10 terabytes of data that Yahoo users generate daily by clicking links (

equivalent of all the text in the Library of Congress), plucking out the relevant bits, compressing it, and storing it. So Yahoo has enough user data to fill more than 1,000 Libraries of Congress.

Of course, all that information would be useless without a way to make sense of them. Before Yahoo bought DMX Gro





A photograph of Tiger Woods in mid-swing on a golf course. A white line with a T-shaped crossbar is drawn over the image, representing a golf club. The text 'stick-to-itiveness 90%' is written in a handwritten style above the club, and 'intuitiveness 10%' is written below it.

stick-to-itiveness 90%

intuitiveness 10%

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ample test of how users interact with a page required help from technologists a month of preparation. Now nearly employees have access to easy-to-use software tools that can run tests over a few hours or days. Along with providing the tools, the SDS department has worked to spread the gospel of data. "We want to use data to make decisions. Don't make decisions based on a fad or what your competitors are doing," says Bassel Bhat, vice-president for SDS.

#### BRITNEY VS. BRITTANY

HELP DRIVE that message home, the SDS team this spring invited Stanford University business professor Robert I. Sutton to speak at Yahoo. Sutton and his Stanford colleague Jeffrey Pfeffer are co-authors of *Hard Facts, Dangerous Half-Truths, and Total Nonsense: Profiting from Evidence-Based Management*. The book owes a lot to evidence-based medicine, an approach in which doctors use results from clinical research to inform decisions about treatment. Applied to business, the approach requires managers to base decisions on facts rather than opinions.

It's this attitude that instead of sitting around having debates about what will work and what won't, let's run some experiments and learn," Pfeffer says. What Yahoo learned often belied initial impressions. Throughout the redesign, the company used a blend of focus groups, one-on-one interviews, test pages and data mining. "What people say they want isn't always what they actually click on," Bhat says. In focus groups, users consistently said they wanted serious world news. "I don't want Britney Spears where on my page," Bhat recalls one user saying. "What if my boss came by and saw?" But when Bhat's team studied users' clicks, world news got little attention, while Britney Spears stories ranked among the most heavily trafficked.

The mixed messages led to important insights. In the end, Yahoo kept world news prominent on the front page because users feel secure knowing that it's easily accessible, even if they don't often click it. Conspicuous placement also went to entertainment, which draws heavy traffic from people seeking a diversion

at work. By contrast, seemingly work-related content such as finance gets ample use in the evening when people pay bills and manage personal portfolios.

Another gem unearthed through data mining: Small changes can make a big difference. The redesign team was excited

## Myth Busters

Data mining upended some assumptions about Yahoo's users

**CLICKMEISTER**  
Bhat oversaw the redesign



**COMMON WISDOM** Users want important world news on the front page and no celebrity gossip

**WHAT THE DATA SAID** The latest dish on Britney Spears gets the most clicks

**COMMON WISDOM** Users want a minimal front page with only a search box

**WHAT THE DATA SAID** People use mail, instant messenger, and news buttons more if they're in one place

**COMMON WISDOM** Moving the search box by a few millimeters won't change how much people use it

**WHAT THE DATA SAID** The slightest repositioning can add or subtract millions of searches

Data: Yahoo! Inc.

about a new feature called Personal Assistant, which lets users hover their pointers over icons to see preview boxes of content such as e-mail. "We knew this was going to be the 'wow' element of the page," Bhat says. But the data showed that users were less than wowed. Turns out the preview boxes opened too quickly, an unusual peeve in this caffeinated, wired world. So the team began fiddling with the speed at which the preview boxes appeared and introduced a slight delay. Bingo.

Although Yahoo's front-page redesign is finished, the testing is not. "There's always some test running," Bhat says. "It's part of our DNA." Now if only Yahoo could collect as much data about its advertisers' spending habits. ■

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# Amaranth's Loss, Wall Street's Gain

The hedge fund's collapse was foreseen by other players, who laid their plans accordingly

BY MARA DER HOVANESIAN

**H**ERE'S A NIFTY BUSINESS: Lend a hedge fund gobs of money so it can place huge bets. Make your own trades based on your knowledge of the hedge fund manager's strategy and your hunch that he's out on a limb. Then, when the fund blows up, swoop in and buy remnants of the business for pennies on the dollar.

In a nutshell, that characterizes Wall Street's relationship with Amaranth Advisors, the Greenwich (Conn.) hedge fund that lost some 65% of its \$9.2 billion in assets when its natural gas trades went south. As of Sept. 27, Amaranth's investors were pressing for total liquidation. The fund's major losses took place in mid-September, but Wall Street traders on the other side of Amaranth's bet on higher gas prices were prepared for the fall. Amaranth "got trounced," says Bill Gruzynski, portfolio manager for Emerald Strategies, a managed futures firm in Chicago. "People started to smell blood and pushed the market against them."

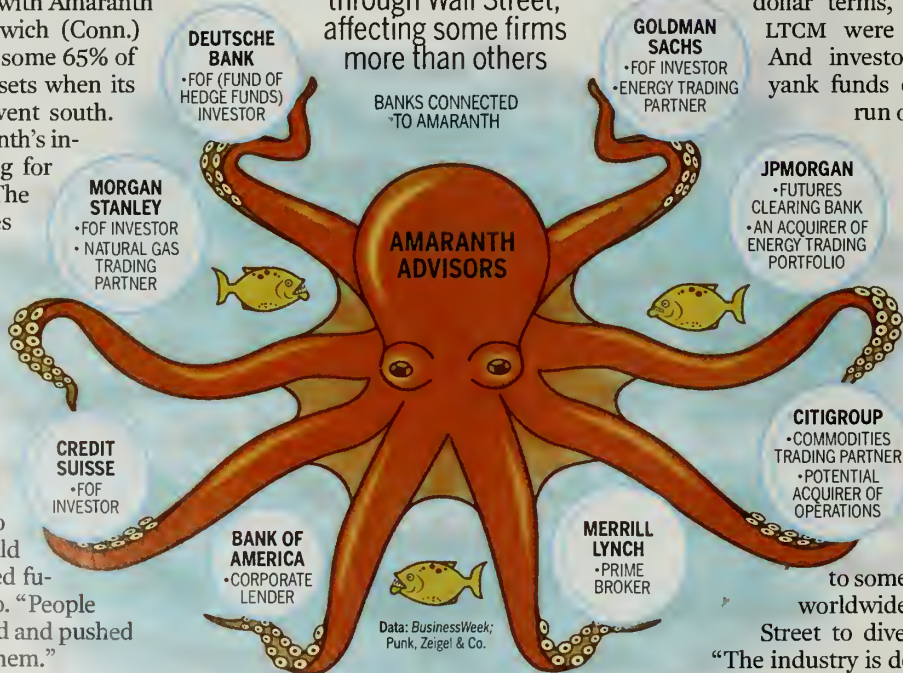
Banks won't divulge much in the way of numbers, but it looks as though Amaranth's loss was Wall Street's gain. "Plenty of people knew [Amaranth] had this position, and anyone trading on the other side said: 'If we knock the price down and force them to sell, we [can] profit from the short sell,'" explains a manager of a large fund of hedge funds.

Short-selling is a bet that the price of an asset will fall. "This," he says, "is what the world does to each other all day long in the futures business."

Amaranth's traders lost money because they expected natural gas to climb. When prices turned, producers dumped supplies

## Long Arms

The sinking of \$9.5 billion hedge fund Amaranth Advisors rippled through Wall Street, affecting some firms more than others



on the market, accelerating the rout. Since Amaranth leveraged up its futures bets even more by borrowing money, losses came fast. "You're overleveraged, everyone knows it, and they move against you," says Jay Gould, a securities lawyer at Pillsbury Winthrop Shaw Pittman.

Then, with Amaranth in meltdown mode, banks moved in to see what they could get on the cheap. Amaranth "shopped their portfolio around widely," says one securities firm spokesman. There were several bidders for what was left of Amaranth's energy trading portfolio; ultimately, JPMorgan Chase & Co. and Citigroup Investment Group in Chicago won. Citigroup is still in negotiations to buy other pieces of the business.

The list of players with ties to Amaranth reads like a Wall Street who's who. Institutional wealth management to lending, the biggest banks kept plenty of tabs on Amaranth and had an opportunity to deploy tactics. Even if some banks suffer losses from their fund of funds investments, their other operations might benefit. Says Mitchell E. Nichter, a securities lawyer and partner with Paul, Hastings, Janofsky & Walker in San Francisco: "Wall Street is willing to absorb losses as a cost of doing business."

## ORDERLY EXITS

WHILE IT'S NO SOLACE to Amaranth investors, the fallout of this fund, unlike the 1998 Long-Term Capital Manager debacle, has been fairly well contained.

Even though Amaranth was bigger in dollar terms, banks' exposure to LTCM were more concentrated. And investors were allowed to withdraw funds early, perpetuating the run on the fund.

Since the late 1990s, banks have grown increasingly adept at using derivatives to hedge their investment exposures. What's more, lenders and investors lock money long, preventing domino effects. And the explosion of hedge funds since 1998—tripling to some \$1.2 trillion in assets worldwide—has allowed Wall Street to diversify its risks better.

"The industry is definitely evolving and becoming more institutional," says Karan Sampson, director of hedge funds at Greenwich Associates, a research and consulting firm for the industry. "It's no longer just a portfolio manager and trader." Explains Nichter: "Every time [banks] run into a situation they haven't thought of before, they tighten up their risk-monitoring process." ■

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# Beyond the 'Strip and Flip'

How Corel, maker of WordPerfect, keeps enriching a private-equity firm

BY NANETTE BYRNES

IT WAS BRUTALLY COLD IN Ottawa in January, 2003, when partners at private-equity firm Vector Capital were negotiating the purchase of software maker Corel Corp. More than once their flights were canceled after temperatures as low as -16F froze aircraft hydraulics. Alex Slusky, founder of San Francisco-based Vector, jokes that the inhospitable weather may be the reason his company

was the only bidder. More likely it was the fact that Corel was losing money, suffering a severe cash crunch, and falling badly behind competitors Microsoft Corp. and Adobe Systems Inc. With its WordPerfect application, Corel was once a serious alternative in word processing, but over the previous decade the company had watched as Microsoft's market share climbed to 97%.

Three and a half years later, Slusky and a lucky few investors in his Vector

Capital II fund have extra plenty from the company, ramping up Corel's debt next to nothing to as much as \$140 million prior to its May 2 initial public offering. Slusky has been able to see a payout in cash dividends and stock sales of more than three times Vector's \$58 million investment. For average Joes, however, it has been a different story. Since the stock has dropped 30% in a recent 11.27, down from \$11.27, that makes it one of the worst performing IPOs of the year, far behind other technology deals and tech stocks in general. It's also near the bottom of the list of deals backed by buyout firms, at 31 on a list of 35 such IPOs, according to Thomson Financial.

But this isn't quite a simple case of a "strip and flip" by a private-equity player. In the past, Slusky has sold investments off to other companies. But by taking Corel public and holding on to 70% of the shares, Slusky has found a way to cash out—and stay in. He says there are plenty of opportunities for Corel to consolidate midsize software

companies. With its equity stake, Vector has a chance to participate in Corel's acquisition strategy. An industry player, Corel can always pay a bit more for an acquisition than a purely financial buyer, Slusky notes, since the operating company can exploit redundancies—synergies, in other words.

## LITTLE PROFIT

JUDGING BY THE stock's dismal IPO performance, however, most investors aren't buying that sales pitch. Should Vector indeed be able to use the stock of a highly leveraged Corel as acquisition currency, it would be applying a typically private-equity strategy to an industry in tech, that is very uncomfortable with debt. Traditionally, tech investors have been growth-focused and debt-averse. Corel, meanwhile, is likely to double its already hefty debt load.

It's even tougher to sell the idea of Corel, which hardly boasts gold-plated assets, can generate enough cash to support an M&A machine churning. Phil Slusky, an analyst at independent Greenleaf (Conn.) IPO research firm Renaissance



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Capital, says investors simply aren't excited by the company or its line of second-tier offerings—WordPerfect and Adobe rival CorelDraw (now both on their 13th versions)—or its niche products like compression software WinZip. “A company like that competing against so many bigger companies like Microsoft and Adobe—there's nothing that appealing about it,” says Stiller.

Corel has turned a profit only once in the past five years. (It made \$1.2 million in 2004.) The company lost \$3.5 million on existing products and services last year, according to a filing with the Securities & Exchange Commission. To try and turn that around, Vector focused Corel's research and development dollars on its biggest brands, like WordPerfect, and tied new product introductions more closely to consumer demands. And as Vector cut Corel's costs, the company was able to get bank lending again. That debt eventually went to fund the \$130 million in dividends that Vector took before the IPO. The company's shareholder equity remains a negative \$28 million, but it has improved over time, and Chief Financial Officer Douglas R. McCollam calls it a “legacy.”

Corel managed to boost revenue 7% and 11% in the first and second quarters of this year, respectively, but investors are likely more focused on the red ink. Indeed, according to David Menlow, president of IPO



Financial Network, IPO investors this year have especially punished companies that have posted losses. Corel's bankers, led by Morgan Stanley, at first predicted the shares could sell for as much as \$20 each, though eventually weak demand forced them to lower that to \$16.

**SLUSKY** ramped up Corel's debt prior to the IPO

## CROWDED MARKET

BUT TRADING PUBLICLY is integral to the company's major strategic thrust. CEO David Dobson, 44, who joined Corel last year after a 19-year career at IBM, is convinced more deals are the way to overcome the slow performance of the company's current products. Vector and

Corel have an active list of 60-plus companies they are monitoring. “Corel spent hundreds of millions of dollars [in the past] to build its sales infrastructure,” says Dobson. “We can leverage that platform through acquisitions.”

With deals come more debt. Its most recent announcement, a plan to purchase DVD software maker InterVideo Inc., will set the company back \$196 million. The board there had other offers and demanded cash. InterVideo does have \$75 million in free cash on its books, but investors expect almost all of the remaining \$121 million balance to be borrowed. Corel has only \$33 million in cash on its own balance sheet.

Even if it manages to bulk up, Corel still faces

withering competition in its markets. Its oldest rivals, Microsoft and Adobe, will introduce major upgrades of their products next year. On the other end of the spectrum, free offerings from Google Inc.—and Corel itself delivers over the Web—could pressure its 30% operating margin. “We've reached a point where it's possible to do more in a browser and deliver a compelling experience there, in many ways as good [you can have with] software,” explains JupiterResearch analyst Joe Wilcox.

Corel's traditional answer to the threat of Microsoft has been to offer a full set of features at 40% to 65% of its rival's price. But today, with a broader set of competitors, Corel is often

giving away basic versions of software or selling them at very low prices in the hopes users will pay to upgrade. That's the plan for its newest offering, the Snapfire digital photo organizer. Corel is arriving years late to a crowded market, which includes Google's Picasa, Yahoo!'s Flickr, and Eastman Kodak's EasyShare. Microsoft's upcoming Windows Live is expected to offer some photo-sharing element, as well.

As Vector's M&A vehicle, Corel is on an uphill climb. But some smart money, ranging from California's Private Employees' Retirement System to Capital, has done very well by investing in Vector. The Vector II fund was launched in the waning days of the tech bubble in 1999. By making new investments from mid-2000 to early 2002, Slusky avoided the fire and had plenty to invest when prices came down. Most funds launched in 1999 have negative returns, but Vector's is in the top quartile, according to London researcher Private Equity Intelligence Ltd., with an internal rate of return of 13.3%.

Even fans of the company acknowledge that its approach, though common to private equity, is foreign territory in the tech industry. “They are employing the same model many industrial companies have employed,” says James M. Tringas, manager of the \$2.4 billion Evergreen Special Values Fund, which bought most of its Corel position as the stock had dropped. “The big question is: Are the cash flows as stable as an industrial company? And I guess it remains to be seen.” ■

## Vector's Angle

The public offering of WordPerfect maker Corel has been part of a successful strategy for its private-equity backer, Vector Capital, but other investors haven't done so well. By the numbers:

**\$130 million**  
Total cash distributed to Vector prior to IPO

**−30%**  
Total return to Shareholders since IPO

**\$90 million**  
Corel's debt

**\$164 million**  
Corel's 2005 revenue

**−\$8.8 million**  
Corel's 2005 net income

**−\$28 million**  
Shareholders' equity

Data: SEC filings, Bloomberg Financial Markets



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## Wal-Mart, Please Don't Leave Me

GSD&M's bid to hang on to a monster client puts the ad agency's overhaul to the test

BY BURT HELM

IT'S A SUNNY JULY MORNING in Austin and four Wal-Mart suits have arrived at GSD&M Advertising for a "chemistry session," the first meeting in a pitch process that will go on for 2½ months. At stake is the right to run Wal-Mart's high-profile brand campaign.

Roy Spence Jr., GSD&M's affable 57-year-old president, welcomes the execs. "To set the right tone, I thought I'd start today by playing a clip. It's from a film I consider to be an epic piece of American cinema." On the conference room's 60-inch plasma television appears a chipped-tooth Jim Carrey wearing a hideous Southwestern-print shirt in a scene from *Dumb and Dumber*. Carrey is imploring his love interest, played by actress

Lauren Holly, to tell it to him straight: "What do you think the chances are of a guy like you and a girl like me ending up together? Like one out of a hundred?" Holly winces. "I'd say more like one out of a million."

Pause. "So...you're telling me there's a chance?" Carrey's face breaks into a smile. "Yee-ah!" he shouts, pumping both fists.

So it is with GSD&M in the wooing of Wal-Mart. This wasn't the first meeting. The agency and Wal-Mart have been partners, along with Bernstein-Rein Advertising

**SPENCE** Inc. in Kansas Mo., for almost years. But now, Mart Stores Inc. w big changes. It aims to cultivate a sophisticated image and has put it count up for review. That's why GS is scrambling. Few ad incumbents win back a client's business.

### NO MORE TEXAS RANGER

GSD&M, FOUNDED by six University of Texas grads 35 years ago, is undergoing its own overhaul and is using Wal-Mart challenge as a live-fire. With their retirement on the horizon, the founders say they want to develop a new process for cooking up campaigns that will infuse each new project with their restless creativity, and every time. They are experimenting with special software and inviting a motley collection of niche experts to help out. So far the agency has made it to the final four and has final meetings with Wal-Mart on Oct. 9.

GSD&M didn't always put such an emphasis on structure and process. Resting a foot on a conference table, Spence reminisces about the first time he flew out to Wal-Mart, solo, to pitch the marketing staff in 1971, a move that surprised them. "I told 'em, it's the Texas Ranger way: no riot, one ranger." The agency was starting to take off. A year earlier, it had coined the slogan "Don't Mess with Texas," created for the state's anti-littering campaign and was the agency's most famous creation. Wal-Mart would be its first national retail client.

Now, GSD&M has AT&T and BMW clients, 850 employees, and roughly \$100 million a year in revenues. The days, Texas Ranger tactics just don't cut it. Although not the CEO (the title belongs to co-founder Steve Casich), Spence and fellow co-founder Judy Trabulsi are the de facto leaders of the Omnicom Group Inc.-owned agency. Both are actively involved

in all new business pitches, and their personalities permeate the agency. Spence, a longtime confidant of the Clintons, has a voice, manner,

**WARM AND FUZZY** Wal-Mart wants a new image







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each pattern that resemble Bill's, the Trabulsi is the calming denominator. They are managing the Wal-Mart pitch together.

The giant retailer's marketing task is a tall order. It wants no less than to reshape its image in the eyes of Americans in 2007. The idea is to inspire the 138 million people who visit its stores each week to frequent

tactics is also a goal. Put simply, Wal-Mart wants Americans to like the company because it is a behemoth and can drive hard bargains and cater to its every need.

A hot-shot marketing team is in place in Bentonville to drive this effort, including 19-year Target veteran John Fleming as chief marketing officer, former Chrysler director

be in charge of the campaign, from the overarching tagline and brand position to individual print magazine ads, a high-profile piece of business.

It's 11 a.m. at GSD&M headquarters in mid-September, and 34 people gather on a second-floor balcony overlooking the central atrium. Like a fighter squadron briefing before a mission, the group sits in neat rows of chairs listening at-

## PLAYBOOK: BEST-PRACTICE IDEAS

### Creativity Supercharged

Austin ad agency GSD&M tackles campaigns quickly with a model it calls "dynamic collaboration." A few of the principles:

#### INCLUDE EVERYBODY

GSD&M invites consultants from widely different backgrounds—from economists to client executives to professional video makers—to participate in brainstorming sessions, .

#### STRIP THE EGO FROM THE IDEA

In the first round, ideas are typed anonymously on laptops. Everyone sees the ideas onscreen, but no names are attached. That keeps the boss and the new hire on the same level.

#### QUANTITY BEGETS QUALITY

Dozens of staffers typing up ideas produces reams of data. Group leaders sift through it, looking for hidden gems that might have fallen through the cracks.

#### ATTACK FROM EVERY ANGLE

The group examines the few winning ideas thoroughly. They battle-test them with harsh critiques before focusing on potential enhancements.

Data: GSD&M



re of its 50 departments each time a visit. It's also building six kinds of customized stores that target inner-city dwellers and affluent suburban—as well as the rural customers who have long been Wal-Mart's mainstay. In a less tangible way, it aims to catch up with rivals like Target Corp. that have succeeded in building a sexier image among the middle class. Sloughing through associations with hard-line labor practices and small-business-killing

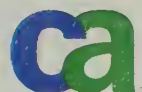
of marketing and communications Julie Roehm to lead the ad review process, and former Frito-Lay chief marketing officer Stephen Quinn. Together they will guide the roughly \$570 million marketing budget. While the winning agency is expected to make only \$6 million to \$12 million in revenue from the account, according to industry estimates (agencies will submit their budgets on Sept. 27), the winner will

tentively as Haley Rushing, an account planning head, speaks in front of a large projector screen. Nearly two weeks earlier, Wal-Mart handed the four finalist agencies—GSD&M; Chicago-based Draft FCB; Martin Agency in Richmond, Va.; and Ogilvy & Mather in New York—an assignment to design test campaigns. One was for the back-to-school season, the other to hawk electronics. The team, composed of more than a dozen outside consultants as well as GSD&M senior

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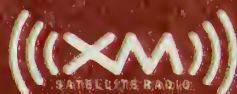
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ff, was chosen to bring as many different perspectives into the room as possible. It includes folks like Neil Howe, economist and co-author of *Millennials Rising*, and twin sisters Amber Dalton and Amy Brady, who play video games on the professional circuit. Each is paid a rate of \$2,500 to \$10,000. Over the next five hours, the group will generate a large number of ideas.

## LONG DAY'S JOURNEY

HEY BREAK OUT into new rooms and h fires up a laptop. Three versions of the same question appear on the different screens: "When it comes to shopping for electronics...what could Wal-Mart do or say to make a [particular of consumers] happy...to make their life better?" With that, strains of the

18th movement of Beethoven's 2nd symphony start to play through the system, and the next five minutes everyone goes like mad.

Spence is typical, away, too. As he enters a cogent

suggestion about how Wal-Mart saves customers' time, out loud he's speaking wise about the music. "I wanna hear money for nothing and chicks for free." Who what? Dire Straits? I know, let's do that! Wal-Mart: 'Money for nothing and chicks for free.'" Bulsi tells him to h. Spence, in many ways, is the reason this part of the process was developed. He tends to make himself the center

of attention. Not only does submitting ideas digitally produce a flood of them to create a permanent record, but the ideas also show up anonymously. A wallflower's idea can be taken as seriously as one from the boss.

A jumble of suggestions has popped up on everyone's computer screens: "Show me the most popular item within each category." "Acceptable price-ins on used products." "Discount competitors' prices on the same item." Five minutes into the session, there are nearly 70 ideas onscreen for each different type of consumer.

The rest of the day's activities are variations on this process. After the first round, the group reflects on what has been entered and types in more thoughtful, developed ideas based on the best elements of what has been suggested. Then the moderators move the group on to new challenges, and they dive deep again. Interspersed are "breakout" sessions in which consultants and GSD&M staffers mix, munch on sandwiches, and plot more detailed plans with a traditional easel-and-magic-marker approach.

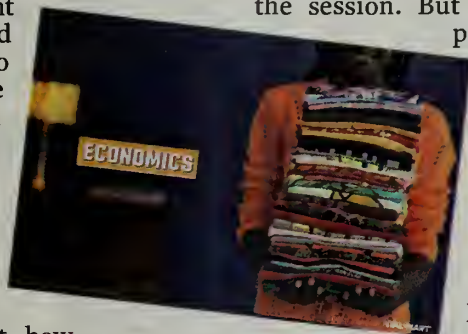
They report to the moderators, who type it all up. These ideas won't necessarily be the ones used. In fact, many can be fairly bland, admits Maury Giles, GSD&M's director for analytics, who helped moderate the session. But team heads will

pore over every last sentence to see if some curious phrase or kernel of a thought in those reams of pages was perhaps overlooked and incorporate it into their final plans.

No two sessions are ever the same. Rather, GSD&M can use the model to break assignments down into their components or generate ideas on an abstract level. Earlier they ran the process in reverse for their overarching tagline and new position for Wal-Mart (they won't say what it is, for competitive reasons): They attacked the developed idea, criticizing it from every angle

to make it bulletproof.

The point is to provide the pitch team with ideas and insights the agency never would have come up with if they'd hunkered down only with one another. "Every industry in the world that is surviving and thriving right now is in a collaborative mode." Using a phrase he often repeats, he adds: "We just don't have the corner on the smart. So we said we're gonna corner the smart people." If Wal-Mart buys that, maybe the Texans will be riding back to Bentonville. ■



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# Boston Scientific's Double Bypass

First, quality problems with its defibrillators. Now, doubts about the safety of coated stents

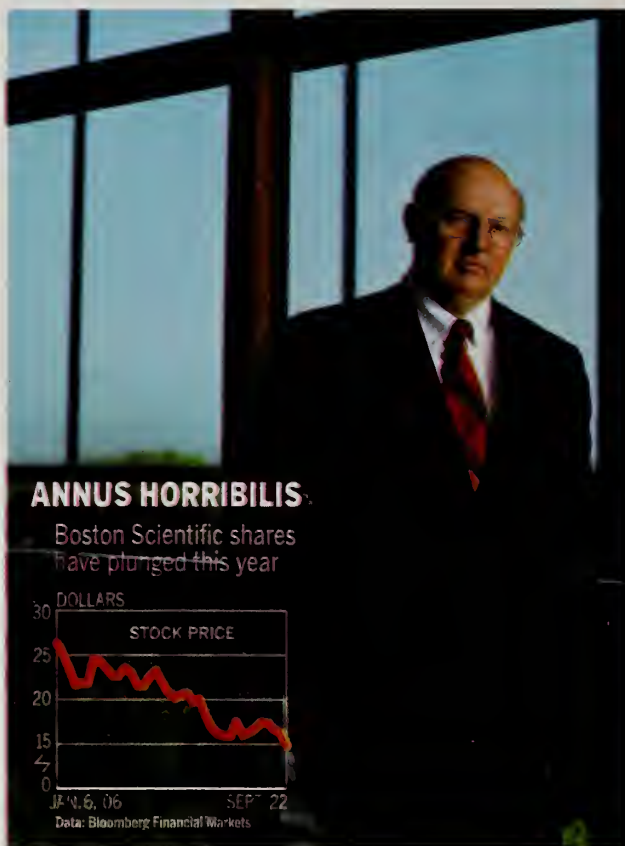
BY WILLIAM C. SYMONDS

**E**VEN AS BOSTON SCIENTIFIC Corp. was trumping Johnson & Johnson to buy troubled Guidant Corp. for \$27 billion last winter, Boston CEO James R. Tobin says he was warning his board to brace for a storm. "We're going to pay a lot of money for Guidant, and then we're going to wake up and discover we have a company with a lot of problems," he recalls saying. "And everyone will be wringing their hands and crying: 'My God, what have these guys done?'"

Cue the hand-wringing. New safety concerns about drug-coated stents, including Boston's blockbuster Taxus product, are fueling fears it will lose its leadership of the lucrative \$6 billion stent market. Last year that business accounted for 41% of Boston's sales and more than half its profits.

Meanwhile, even as Tobin tries to turn Guidant around, the entire market for that unit's key product—implantable cardioverter defibrillators (ICDs)—has jerked into reverse. After growing 20% for each of the past several years, sales of these \$25,000 devices for spotting and correcting abnormal heart rhythms are now falling. The culprit: Guidant's embarrassing string of quality-related recalls last year.

It's doubtful even Tobin expected things to get as bad as they have in recent weeks. With its two key products under fire, Boston warned on Sept. 21 that third-quarter earnings would come in well below expectations. That drove its once high-flying stock below \$15, about 46% off from its level when Tobin began bidding for Guidant. At today's prices, Boston is now worth just \$22 billion, or \$5 billion less than it paid for Guidant. To top it all off, on Sept. 26, J&J



sued Boston, Guidant, and Abbott Laboratories for \$5.5 billion over the deal, alleging that Guidant leaked confidential information during the negotiations. No wonder critics are howling. "That deal is unfathomable," says Matthew Dodds, a Citigroup analyst who has a sell recommendation on the stock. "And I don't see any light at the end of the tunnel."

While the troubles mount, Tobin is serene. "We would absolutely do the Guidant deal again today," he insists. Largely thanks to Taxus, Boston's sales have doubled since 2002, to \$6.3 billion.

**CEO TOBIN** must hang on to market share in stents to pay off debt used to buy Guidant

But the stent market is now largely rated. "We need to be \$10 billion to 1 the hit parade" in the medical device market, says Tobin, whose chief rival is \$12 billion Medtronic Inc. and \$50 billion J&J. Tobin insists Boston will remain the leader in stents. As for Guidant, "get the problems fixed, the new product flow will resume, and it will become the growth engine of the company."

Tobin's most pressing challenge is to defend his stent business, which is counting on to pay off the \$8 billion debt he assumed to buy Guidant. The debate over the safety of such devices escalated (page 93). But Tobin says his own long-term patient data suggest

that "the balance of risk and reward clearly favors drug-coated stents" such as Taxus over the bare metal stents they largely replaced.

## CLOT FACTOR

**TOBIN FIGURES** that every 1,000 patients who get a bare-metal stent to clear clogged arteries, 200 will need to repeat the procedure, and 20 will die from a serious heart attack. Using a Taxus stent appears to cut that number in half by addressing the recurring problem—coronary restenosis.

Long-term results now suggest 5 out of 1,000 Taxus patients will eventually suffer a heart attack triggered by a blood clot. That's still just 15 heart attacks for Taxus stents for bare metal stents, "you're better off with Taxus," he says.

For now, most cardiologists will probably stick with Taxus

or its only U.S. competitor, J&J's Cypher. Dr. Richard W. Nesto, a cardiologist at Lahey Clinic in Burlington, Mass., says bare-metal stent usage will increase from 10% of all procedures to 15% he predicts. But there may be a bigger problem for Boston Scientific: The blood clot risk with drug-coated products means "the market is ripe for new entrants, and if their clinical data



od, there will be major market-share changes," he warns.

In fact, Medtronic, Conor Medsystems, and Abbott are all readying new stent offerings in the U.S. Each argues that its products are safer—and cardiologists can adopt quickly if they believe a new stent is superior, says Harvard Business School professor Robert Huckman. Boston controls about half the stent market today, argues Jan Ward, an analyst at A.G. Edwards Inc., but by 2009, "they could be with just 25% to 30%."

All of these players, Boston included, will face fresh hurdles when their new stents are reviewed by the Food & Drug Administration. Given how long it took for problems with drug-coated stents to surface, regulators may hold new products to a higher standard. Even so, Tobin hopes the FDA next year will approve Boston's Taxus Liberté stent, which is easier to implant than the current Taxus and has already replaced the earlier versions outside the U.S. Boston will also benefit if Abbott's new stent takes off, as it has co-marketing rights to that device. And in late 2008, Tobin hopes to launch a next-generation stent he named Barracuda. "No one can compete with our continual flow of new technology," says Paul A. LaViolette, Boston's chief operating officer.

The hard part will be mending Guidant's ICD business. After repeated recalls and an FDA warning letter, Guidant's share of the ICD market has shrunk to 25%, down from 40% two years ago, says Citigroup's Dodds. Tobin now spends nearly every Monday and Tuesday at Guidant's headquarters in St. Paul, Minn., where he's directing the turnaround. He has already brought in new people to head research and development, quality, and manufacturing, as well as to run Guidant's three plants. He has cut the number of projects Guidant is working on, and increased the frequency and intensity of product quality testing. Guidant's quality problems were a bad omen to the industry. Defibrillators are technological marvels that can bring a patient who suffers sudden cardiac arrest back to life, but fear of malfunctions has scared doctors and patients to think hard. "It's all the sudden-death malaise," says Eric N. Prystowsky, vice-chairman of the Heart Rhythm Foundation.

Optimistic as Tobin is, he doesn't imagine that the problems in his stent and defibrillator businesses can be handled quickly. "Some people say we have a communications problem," he says. "But the real issue is, how do we avoid having this thing to communicate?" ■



**VIRMANI**  
She has already fielded calls from attorneys

## 'No One Wanted To Hear'

Renu Virmani warned that, over time, some drug-coated stents could lead to fatal clots

BY JOHN CAREY

**T**WO YEARS AGO, AT A meeting of top heart doctors in Paris, Dr. Renu Virmani tried to dampen the raging enthusiasm for drug-eluting stents—new devices that prop open narrowed blood vessels and exude chemicals to keep them open. The stents were having a glorious sunrise, she said, because they prevented blood vessels from renarrowing. But inevitably "the sun would set," she warned, as patients with the stents ran into deadly problems.

Based on her years of experience and studies, the Indian-born Virmani was troubled by the devices, but at the time "no one wanted to hear what I was saying," she recalls. For one thing, the message threatened products from Boston Scientific Corp. and Johnson & Johnson viewed as breakthrough treatments with multibillion-dollar potential. And as a pathologist with a flair for the dramatic, Virmani was seen as both an alarmist and an outsider in

the elitist world of interventional cardiology. "There was hostility," says Dr. Steven Nissen, chair of cardiovascular medicine at the Cleveland Clinic. "No one likes someone who is saying what you are doing is not the right thing."

They're listening now. Over the past two years, doctors have noticed that patients with the new stents sometimes suffer fatal heart attacks months or years after the devices were inserted. At her nonprofit laboratory, the CVPPath Institute in Gaithersburg, Md., Virmani, 64, has vivid microscope slides showing why: The victims' stents are totally blocked by clots. New analyses of the data from clinical trials, reported at a meeting last month in Barcelona, show that such late-occurring clots form more often with the new stents than with old bare-metal ones. In its own trials with its Cypher drug-eluting stent, J&J's Cordis division said in a written response that five patients have had late clots, compared with zero for bare-metal stents. The company says the difference is not statistically significant, but that



"it is an important clinical challenge."

Prominent cardiologists like Nissen are calling for a large, long-term trial to figure out the size of this problem. The Food & Drug Administration terms it "a small but significant increase in the rate of death" and is convening a panel to examine the risks. Cardiologists estimate that the drug-coated stents may be causing 5 to 15 more clots per 1,000 people than the bare-metal stents. That's not a big number, but such a clot "is a catastrophe," explains Dr. Robert S. Schwartz of the Minneapolis Heart Institute; "100% of patients will have an infarction, and 20% to 40% will actually die. With millions of stents, that's a lot of catastrophes—10,000 to 30,000 patients per year."

## MASS TORTS?

THE CLOTTING PROBLEM is catching the attention of trial lawyers, who are exploring the potential for litigation. Virmani is among the researchers who have already fielded calls from attorneys. So far, trial lawyers say that the grounds for mass torts are uncertain because the late-occurring clots appear to be a side effect rather than the result of a product defect. The analysis of the issue at the personal-injury firm Parker & Waichman is "really preliminary," says lawyer David B. Krangle. But, ever provocative, Virmani suggests that drug-eluting stents could be another Vioxx, the Merck & Co. painkiller whose link to heart disease sparked many lawsuits.

The function of the small metal tubes known as stents is to prop open narrow arteries. Once a stent is inserted, the blood vessel grows new layers of cells over the metal as part of the healing process. That's a good thing, but problems arise when the healing is too vigorous and the resulting layer of cells is too thick. The vessel narrows, causing symptoms like chest pain. Current thinking is that 15% to 30% of patients who get first-generation bare stents will have this problem, called restenosis, although one new study suggests that the rate could be as low as 8%.

That's why researchers have been seeking ways to tame the over-exuberant healing process. The first promising approach, embraced by cardiologists in the 1990s, was zapping blood vessels

with radioactive seeds for a short time after stents were inserted. Virmani, then head of cardiovascular research at the Armed Forces Institute of Pathology, was skeptical. The radiation would only delay restenosis, she warned, while damaging the vessel and leading to other ills, like clots. After being a lonely voice of caution for years, "I was proven right," she says.

Now doctors typically use drug-coated stents instead of radiation. Millennium Research Group estimates 920,000 patients in the U.S. will get them this year. The drugs—an anti-cancer agent in Boston Scientific's Taxus and a potent im-

before the first one was approved in 2001. Her doubts were soon strengthened by a European doctor involved in trials with a patient who died 16 months after getting a Cypher stent, and sent sample slides to Virmani. She showed that there was no healing at the site of the stent—and enough, there was a clot. She also showed a hypersensitivity reaction in another patient. The cases were "a revelation we were on the right track," she says. "But J&J didn't want to believe it."

J&J's Cordis division says the company convened a panel of experts to review Virmani's work and concluded the clot was

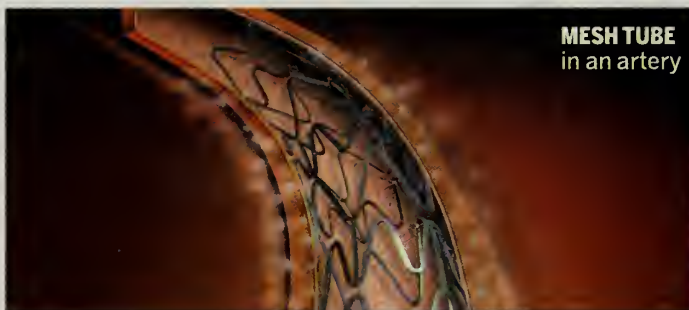
an anomaly. "Hypersensitivity to the Cypher stent or its components, if it were observed, would result in restenosis and not thrombosis," the spokesman said. Boston Scientific notes that bare-metal stents can also cause cardiac problems (page 92). The flamboyant Virmani, who went through boot camp training in her 40s and served as a lieutenant colonel in the U.S. Army Reserve, doesn't buy these arguments. "I would never take a drug-eluting stent," she says. "The chances of thrombosis are so high."

While doctors are just starting to figure out the actual incidence of harm from the stents, the work of Virmani and others points to several ways of using the devices (see sidebar). Doctors understand that ending treatment with the anti-clotting drug Plavix is dangerous. Again and again, they see stent patients go in for additional surgery months later, and stop using Plavix to avoid excess

bleeding during the procedure, only to suffer a heart attack. "I don't feel comfortable telling my patients with stents to stop Plavix, ever," says Schwartz.

Some cardiologists are already swinging back to bare-metal stents, causing Boston Scientific to lower its revenue projection. And companies and researchers are redoubling their efforts to come up with less risky, next-generation drug-eluting stents, some with lower levels of drugs or a more biocompatible polymer.

Doctors, meanwhile, have learned to take Virmani's warnings more seriously. At the Paris meeting this year, she was given a major award for contribution to interventional cardiology. "She has been somewhat prophetic," says Nissen. ■



**MESH TUBE**  
in an artery

## Using Stents Sensibly

Dangerous clots raise questions about the widespread use of drug-coated stents. Here's what patients need to know:

**RISK OF BLOOD CLOTS** is higher with longer drug-coated stents, or when two stents overlap

**ACTION:** Be more conservative, using shorter stents and avoiding overlaps

**WITH LARGE BLOOD VESSELS**, there is relatively little chance of renarrowing after a stent is inserted

**ACTION:** Consider using bare-metal stents in those arteries

**SINCE CLOTS FORM WHEN** anti-clotting drugs are stopped, patients must take those medications for months or years

**ACTION:** If candidates for stents might need future surgery—which requires stopping the drugs to prevent excessive bleeding—use bare-metal versions instead

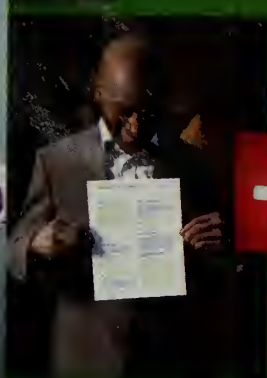
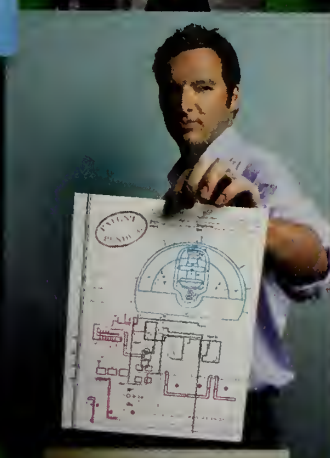
mune-system suppressant in Cypher—are secreted by a plastic polymer in the stent to slow healing.

The problem is that "delaying healing is a double-edged sword," Virmani explains. Examining stents under the microscope months after they were implanted, Virmani often finds that no new protective layer of cells has formed. As a result, the body still views the site of the stent as an unhealed wound, so it sends in a clotting protein to speed the healing. That, in turn, can lead to a deadly clot, called a thrombus. What's more, work by Virmani and others shows that the polymer itself can trigger an inflammatory response, compounding the problem.

Virmani was leery of such stents even



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## INNOVATIONS

### Of Einstein's accuracy and carbon monoxide cures

» Einstein was right. Some 90 years after the genius published his theory of general relativity, an international research team has proven he was at least 99.5% correct. It came up with the proof by measuring radio waves tossed off by a pair of massive stars rotating around each other. Albert Einstein posited that space and time are connected, and

massive objects can warp both of them. The researchers figured that should mean that radio pulses from one of the stars would slow down when they got close

to the other. Three years of observations proved this to be the case.

» Carbon monoxide may not be all bad. The gas, which can be deadly in high concentrations and is emitted from auto tailpipes, could be effective in treating pulmonary arterial hypertension. This debilitating disease occurs when blood vessel walls thicken because of uncontrolled cell growth. Researchers in Boston and Pittsburgh reported in *The Journal of Experimental Medicine* that they exposed mice with the disease to a short, daily regimen of carbon monoxide. The gas killed off the excess cells but not the normal ones and reversed the course of the illness in the animals.



## GREENHOUSE GASES A CLEANER WAY TO MAKE STEEL

FOR INDUSTRIES SUCH AS steel, greenhouse gas (GHG) emissions are more than just an environmental worry. With ever more countries taxing carbon output, cutting emissions can also be a way to fatten the bottom line. Now Massachusetts Institute of Technology scientists have come up with a way to process iron—a key part of steel—that eliminates direct emissions of GHGs.

The recipe uses about as much energy as today's process, says Donald Sadoway, professor of materials chemistry. The advantage comes from a smelting trick borrowed from aluminum: passing electric current through a liquid mix of iron oxide, rather than heating it thermally to trigger a carbon-intensive chemical reaction. Sadoway's "molten oxide electrolysis" process gives off mostly oxygen, rather than plumes of CO<sub>2</sub>. His next goal: scale up the process from lab to factory floor. —Adam As

## DIABETES THE VEXING SUCCESS OF AVANDIA

SOME 18 MILLION Americans have Type 2 diabetes, and 41 million more are at high risk of developing the disease. A newly published study finds that the "at risk" group can cut the odds of developing diabetes by 60% if they take Avandia, a pill used to treat the disease. The results create a conundrum for doctors, however: Diet and exercise can lower the risk by the same amount, without the potential side effects of a daily pill. "But lifestyle changes have limited usefulness because so few people are willing to make them," says Dr. Jill Crandall, head of the diabetes prevention program at Montefiore Medical Center in New York.

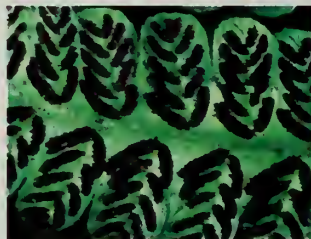
Avandia is made by GlaxoSmithKline, which also sponsored the research. For three years the study followed

5,269 patients in 21 countries with impaired glucose tolerance, half of whom were given Avandia.

Reporting in *The Lancet*, the researchers projected that 144 cases of diabetes could be prevented for every 1,000 pre-diabetics treated with the medicine. The patients on Avandia did have a slightly

higher rate of congestive heart failure, which specialists say could limit its effectiveness. At about \$170 a month, the drug could also be costlier than lifestyle changes. But as Crandall notes, insurance companies are more likely to pay for the drug than to cover the costs of a dietician or fitness trainer.

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cells in the outer walls of a fern's tendrils are waterlogged, water tension keeps them closed like a fist, storing the fern's spores inside. Tension is released as the tendrils curl out, and they unfurl, ejecting the spores into the air. Borno and Assistant Professor M. Mahabiz designed a silicone device shaped like a tiny fern with ribs fanning out from a curved spine. They filled spaces between the ribs with water, applied heat, and the device straightened out. Now the team will try to generate electricity with this trick.



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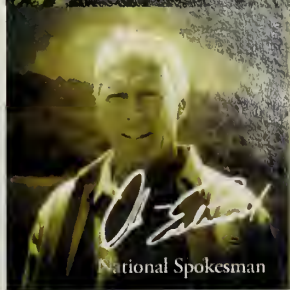
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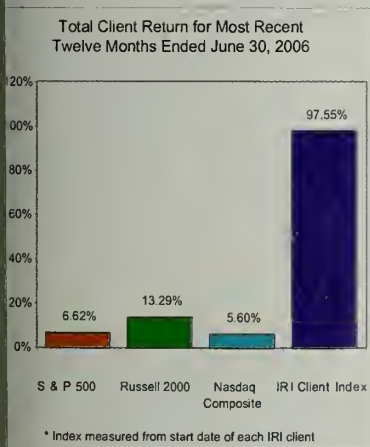
**How do you measure your investor relations program's ROI?**

Just how efficient is the stock market? Regions of academic economists have argued that investors already know the pertinent facts about publicly traded companies, and that the companies are priced accordingly. But tell that to CEOs of countless small-cap firms, with no analyst coverage and little or no attention from institutional investors.

There are thousands of such companies, in the U.S. and overseas. They are publicly traded but thinly traded and largely ignored. They have attractive stories that go unheard. They fail to reach the long-term, committed shareholders they need.

### The IR Effect

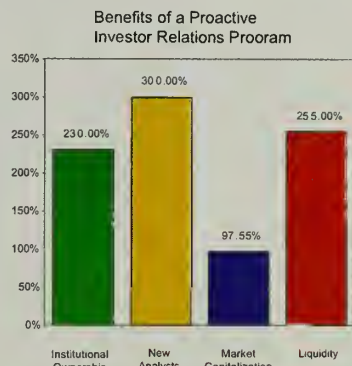
This is where an investor-relations strategy comes in. A good IR firm makes a difference by helping a company refine its story and, if needed, improve its disclosure. The



The firm also connects its client with serious investors, institutional and retail, who are capable of giving it long-term support. IR consultants also use their own visibility in the investor community to generate trading activity and liquidity.

### Lasting Value at Home and Abroad

Companies pay plenty of attention to investor relations when they go public or



\* Based on latest TTM results of average IRI client

complete a financing. IR is crucial afterwards as well. Share prices of most companies that have completed a financing typically decline until they hit the discount level at which the financing was completed. A good IR program helps offset this momentum by building and maintaining support.

IR also helps overseas companies fight the lost-in-translation syndrome. Take a Chinese manufacturer. American investors are intensely interested in the Chinese economy, which has lately been growing at over 9% a year. Most individual Chinese firms need IR help to explain their business models and to meet U.S. standards for disclosure. Good IR makes the operations and finances of overseas firms more transparent. It reduces the sense of risk that comes with uncertainty.

A small company trying to be heard should be asking itself some simple questions: Who are the investors we are trying to reach? What do they need to know? Who can connect us with them? What is our story, and can we improve it? The next step is to ask if the firm has the specialized skills and investor network to deal with these issues on its own. If the answer is no, outside help is in order.

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# Free Downloads— After This Message

Will users wade through ads instead of paying for music, video, and books?

AULA LEHMAN

FOR JOE MOHEN, A SOFTWARE industry veteran, the lightbulb moment came earlier this year after a brassy intern spoke his mind. Mohen was in a meeting with lawyers and music executives to discuss ideas for a new online service. "Those all s--k," Mohen remembers his 19-year-old intern interjecting. "Why don't you just give it to us for free?" The conference room fell silent, executives aghast. But then Mohen thought to himself: The kid is right. Why not?

After all, the dilemma facing any owner of copyrighted works continues to be how to compete with free given that the unauthorized use of online of books, music, and videos is still rampant (table). But Mohen's plan is to offer music free and ensure that the record labels get paid. The concept? Sell advertising and offer companies the bulk of those revenues. To help woo Madison Avenue, Mohen hired Robin Kent, a former chairman of giant Universal McCann Worldwide, as his CEO, and SpiralFrog was born. SpiralFrog is one of a handful of new

services introduced in the last two months that offer music, videos, and, in some cases, books for free in exchange for users having view advertising. For services like music and publishing, which are largely transactional, experimenting with an ad-based model is fresh territory that ultimately deliver a new revenue stream and battle piracy. "Record labels are in desperate need to target their increasingly distracted audi-



ences," says Russ Crupnick, an analyst at consultancy NPD Group Inc. "You have to try different models." Another variation: T-Mobile International will

offer music videos of EMI artists for its cell-phone customers preceded and followed by 15-second ads. And Warner Music Group is linking up with video site YouTube to provide copyrighted material in exchange for ad revenue.

True, these new ad-dependent services come with risks. Advertising is more susceptible to swings in the economy than subscriptions or straight sales. That could make for even more vola-

tility, especially in music, which has seen plenty since Napster began demolishing bottom lines seven years ago. What's more, forcing users to navigate through a series of ads before getting to the music or novels could try consumers' patience. There's even the potential for backlash, if not among users then among musicians and writers. When Kurt Vonnegut learned that users downloading his novel *Slaughterhouse-Five* on the new e-book retailer WOWIO will have to flip through ads like one for Verizon Communica-

tions Inc.'s "Chocolate" mobile phone, the 83-year-old author snapped, "This is just tasteless," and hung up the phone.

## AD REVENUE

WOWIO'S EXECUTIVES insist the ads aren't intrusive. Users can create profiles where they specify interests (food, TV, music), so that PDF-formatted e-books can be embedded with appropriate ads every 30 pages or so. Says William Lidwell, founder of WOWIO, which so far offers 400 titles: "We want to make anything anyone wants to read available for free so that someone who might not have ever read Vonnegut will pick it up now."

SpiralFrog, expected to be up and running by yearend, is still negotiating with music companies and big marketers.

The plan is that SpiralFrog would pay the labels enough from ad revenues to compensate for what they would forfeit in per-tune fees, says CEO Kent. So far, EMI Music Publishing and Universal Music Group have signed on. Consumers will be able to select a track and download it in 90 seconds. In that time, they will watch ads and be directed to other areas of the site. Then the song can be played endlessly (limited to two portable devices), as long as users log on to the SpiralFrog site once a month. Otherwise, songs will expire.

Could these new models finally steer users away from illegal sites for good? "We're trying to strike a balance between protecting our artists," says Adam Grossberg, a spokesman for EMI, "and providing content to our users." In the age of free, never an easy thing. ■

## THE STAT

**20**  
Billion

Estimated number of songs that were illegally downloaded or swapped in 2005

Data: Intl. Federation of the Phonographic Industry



# Working Out With...

...Restaurateur Danny Meyer. His killer gym sessions help his back—and head. **BY LAUREN YOUNG**

**C**OLLAPSED ON A BLACK GYM MAT with his long limbs splayed, Danny Meyer looks like a frog. Not the frog featured in the Poached Organic Egg with Everglades Frogs' Legs and Oregon Blue Foot Mushrooms that is on the \$76 tasting menu at Eleven Madison Park, one of Meyer's 11 New York restaurants. No, after a strenuous 60-minute workout, his eyes are glassy, his legs are floppy, and his skin has a sweaty sheen. **1** Considering that Meyer, 48, spends nearly every waking moment around food, you might think he subjects himself to the one-hour equivalent of Marine Corps boot camp simply to

stay thin. But Meyer, who was a husky kid, says his thrice-weekly workout session with fitness guru David Kirsch isn't about keeping a lid on his weight (165 pounds). "I use this time to work out my aggression and stress," he says. He also gets an energy boost.

Before he started training with Kirsch four years ago, his main exercise was running. Yet with all the time Meyer spent on his feet and all the lifting that came from parenting four kids, now 7 to 13, "my back was killing me."

Meyer tried to alter his exercise routine by visiting a downtown gym, but customers constantly spotted him and want-

ed to talk food. "It wasn't my time," he says. A St. Louis native, Meyer is too Midwestern and too focused on hospitality to be anything but polite. In fact, he spells out his philosophy on keeping customers and staff happy in his new book, *Setting the Table: The Transforming Power of Hospitality in Business* (HarperCollins). "Business, like life, is all about how you make people feel," Meyer writes. "It's that simple, and it's that hard."

Meyer knew Kirsch as a customer, and the trainer invited him to his private gym, Madison Square Club, for a workout. After one distraction-free session, Meyer was hooked. The gym is also less than a



10-minute walk from his home and to his 11 restaurants, which include Union Square Cafe and the Gramercy Tavern. That was appealing, too.

To cure Meyer's back problems, Kirsch designed a fitness regimen that emphasizes building his core strength. The workout is typically focused on abdominal exercises, which may include—much to Meyer's dismay—stomach crunches using a medicine ball that he tosses and forth to Kirsch as he sits up. "You mean, mean, mean," Meyer says near his 15th sit-up. Another ab exercise he loathes requires him to hold his body in a pushup position while keeping his feet out across the floor. Kirsch designed the workout menu to keep it interesting.

## "CARB FACE"

MEYER MAY BE THE culinary expert, but Kirsch dishes out plenty of dietary advice. Meyer showed up for his first workout wearing a "Grateful Palate Back to the Month Club" T-shirt. Kirsch—





**1 PARALLEL CABLE CROSSOVERS**  
To build upper body strength, lean forward with one foot in front, and push the weight forward and let it come back slowly.

**2 BASIC CRUNCH**  
Exhale as you sit up, contracting the lower tummy. Don't let your shoulders touch the floor as you roll back down.

**3 OBLIQUE CURLS**  
Lie on your side with your arms crossed and hip at the edge of a bench. Curl up and down slowly. It helps to have a friend sitting on your feet to provide stability.

**4 SHOULDER PRESS**  
Grasp a dumbbell in each hand with arms bent at 90 degrees. Alternating arms, extend slowly upward until your arms are straight, and then lower.

of a gourmet meal is an egg-white pasta with turkey sausage and a vitamin E—banned the shirt. Meyer learned the mindful about what he consumes the night before a workout. “David can’t really tell what I ate for dinner,” Meyer says. Pasta is out, since Kirsch will chide him for having a bloated “carb face.” Clearly some of Kirsch’s eat-healthy habits have rubbed off: Meyer tries to eat a salad for lunch, and he serves Kirsch’s proprietary vitamin drinks at

the Shake Shack, his upscale hot dog and hamburger stand in Madison Square Park.

The client-trainer relationship can be an adversarial one, as when your trainer is yelling at you to hold wobbly legs in a squat for another 30 seconds. Expletives fly. “I know he is on my side,” Meyer pants, as he does side crunches off a bench with Kirsch sitting on his feet. “But sometimes it doesn’t feel that way.” Yet the two clearly like each other. They com-

pare notes on baseball—Meyer is a St. Louis Cardinals fan, but he holds season tickets for Kirsch’s favorite team, the New York Mets.

Sometimes Meyer can’t resist tormenting his torturer: “Anyone want to go to the Shake Shack? I think I’ll get the cheese fries,” he says after he collapses on the mat for his final stretch. Although Meyer is a sweaty mess, the session ends with a hug, albeit one with a clean towel between the two men. ■

## Meyer's Training Menu

All exercises are done in two sets of 15 to 20 repetitions

Warm up on an elliptical trainer (5 min.)

Push-ups on body ball

Squat thrusts with weights

Dumbbell curls to shoulder press with 20-lb. weights

Reverse crunches

One-arm pushup on a medicine ball

- Parallel cable crossovers
- Plank position (hold for 30 sec.)
- Push-ups with hip extensions
- Shoulder presses with dumbbells, lying down (first with 25-lb., then 35-lb., weights)
- Sit-up volley throwing medicine ball
- Push-up position with frog-leg kicks
- Oblique curls on bench
- Bench crunches holding 10-lb. and 15-lb. weights
- Stretching (10 min.)





# Hybrid Goes High Class

Lexus rolls out the most expensive, luxurious, and fastest gas-electric ever, giving Prius-loving celebrities a reason to trade up. **BY MATT VELL**

**Bang for the Buck** At \$55,615, the GS 450h carries a \$2,525 premium over the conventionally powered GS 430. It also comes with a batch of costly extras that are options on the regular model. These include ventilated front seats, rearward parking camera, rain-sensitive windshield wipers, rear-window sunshade, and headlight washers.

**Style Points** The GS line was intended to be Lexus' design crown jewel, and this version refines the shapes and proportions of previous incarnations. The deepened creases and arcs of the hood are a start, but styling is still not as sharp as classmates BMW and Mercedes.

**Extra Credit** The GS 450h is currently eligible for a \$1,350 tax credit. But under IRS rules more complicated than the technology under the hood, that benefit is set to gradually decrease and eventually expire over the next four financial quarters.

**Full Monty** Unlike some competitors' so-called mild hybrids, the GS is a full hybrid. That means it can run in gas-only or electric-only modes, or a combination of the two, depending on driving conditions.

**Rearward-Ho!** Unlike other hybrids, including Toyota's Prius, the GS has rear-wheel drive. That's less efficient than a front-wheel drive setup, but an absolute must for sports-oriented driving.



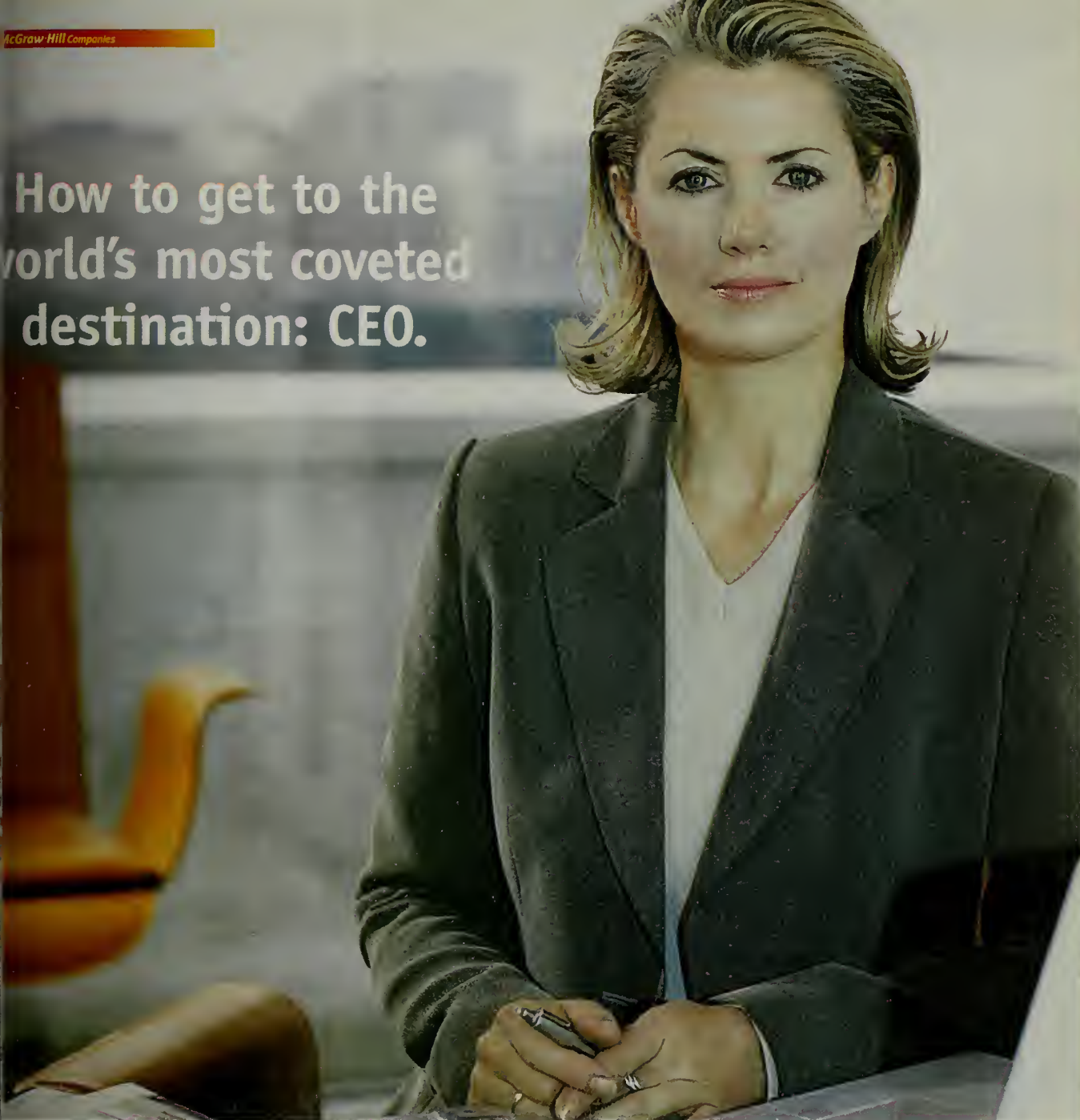
**Dial It Up—and Down** The instrument panel is lit with the help of sensors that change illumination and transparency depending on ambient light conditions.

**Magic Tricks** To avoid the button overload and dash clutter that comes with so many techy features, Lexus designers have stowed least-often-used controls in fold-away compartments that pop open at the press of a button.

**Eco-Fast** Though it only gets 25 to 26 miles per gallon, it shoots from zero to 60 in a mere 5.2 seconds. With an assist from its electric components, the 3.5 liter V-6 cranks out 340 horsepower, a figure more likely to come from a V-8. Better yet, maximum torque is available at passing-crucial speeds, between 30 and 50 miles per hour.



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# Lassie, Come to Houston

The pet-friendly city makes it easy for road warriors to take along their pooch. **BY KATE MURPHY**

**ARE YOU FEELING** guilty about leaving Fido or Fluffy at the kennel while you're away on business? If you're headed to Houston, maybe you should take them along. The American Automobile Assn. rates it the most pet-friendly city in America, at least if you go by the number of AAA-approved hotels that accept four-legged guests.

At the 314-room Hotel Derek in the city's tony Galleria area shopping district, dogs and cats get

their own beds, water and food bowls, and a gift bag of toys. Pet sitting is available, and room service will deliver cooked-to-order wow and meow chow. "We realize your dog or cat is part of your family," said assistant front office manager George Treviño, who was recently dispatched to get a carpeted kitty condo for Cher's cat, Mr. Big.

The Four Seasons, Westin, and St. Regis hotels confer posh pet

privileges in keeping with their nationwide policies. Smaller lodging facilities, such as the 14-room Lovett Inn in the museum district, also allow pets but don't serve them treats on silver platters.

During your free time you can take your buddy for a romp in one of several canine parks, including the 15-acre Millie Bush Bark Park, named for former President George Bush's late spaniel. It has walking trails, swimming ponds, and paw-operated drinking fountains. Hungry? Stop at one of three Barnaby's Cafes, known for their multi-ethnic menu, decadent layer cakes, and dogs lying under patio tables at their owners' feet. ■

◀ **PLAY TIME**  
Romper (left and below) at the Millie Bush park



◀ **POSH** Four Seasons serves its pet meals on silver trays



## DOGGIE SHOW

**YOU CAN'T TAKE** a dog to Houston's Museum of Fine Arts, but you can see its new exhibit, **Bark in Show: The Dog in Art from the Renaissance to Today**, which opens Oct. 26 and runs through Jan. 21, 2007 (mfah.org).

It features 75 pooch paintings, photographs, and sculptures starting in the 16th century. Among the pieces: *Two Dogs in a Landscape* by Jacopo Bassano (above). Cat lovers shouldn't feel left out. **Tail Cat's Meow**, a show of 20 feline-related works, is on display until Jan. 21, 2007.



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BY ROBERT PARKER

# From Northern Spain Seafood's Soulmate

Albariño is the only Spanish wine known by the variety of the grape. If these wines were tagged like others from Spain, they'd be called Rías Baixas. That's the cool, wet viticultural area in the Galicia region of far northwestern Spain where the grape grows. It's a lush landscape marked by rías—fjord-like inlets—that run inland from the Atlantic Ocean. ¶ Albariño is a light- to medium-bodied, fragrant, floral white wine that shows remarkable flexibility with food. Its sharp acidity allows it to pair especially well with seafood, which also happens to be the mainstay of the local cuisine. The wine rarely ages well, so readers should be buying the 2005s, which are just being released.

## Bodega Nora

**86 points.** Crisp and elegant, the wine offers up notes of melons and tropical fruits buttressed by crisp acidity and a light- to medium-bodied style. While not complex, it is a fresh, lively white that will go beautifully with seafood dishes. Enjoy it over the next year. \$16

## Bodegas As Laxas

**87 points.** This wine exhibits hints of honeysuckle, orange rind, and apricots in its quasi-Condrieu nose. (Condrieu is a northern Rhône appellation that produces fragrant viognier-based whites.) Medium-bodied with fine acidity and abundant fruit, it can be enjoyed over the next 12 months. \$18

## Lagar de Cervera

**89 points.** This offering reveals an exotic, Condrieu-like flamboyance backed up by fine

minerality, medium body, and loads of tropical fruit. Consume it over the next year, preferably with seafood. \$19

## Bodega Castro Martin

**88 points.** Aromatically demure, Castro Martin's albariño explodes on the palate with melon balls, spices, salty minerals, and flowers. This light- to medium-bodied white is satin-textured, expressive, and sports a lengthy finish. \$20

## Do Ferriero

**91 points.** This steely white exhibits a straw-green color as well as superb purity, loads of texture, and a honeyed, rich, elegant, bone-dry style. \$24

## Pazo de Señorans

**92 points.** This is from one of my favorite albariño producers. Low-yielding (25-30 hectoliters per hectare) old vines planted in the northern

sub-zone of the Salnes appellation have produced a wine with impressive textures of exotic peach, apricot, pineapple, and honeysuckle characteristics, superb ripeness and richness, good acidity, and great length as well as minerality. This is a stunning no-oaked dry white to enjoy over the next one to two years. \$25



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# An ETF for Every

Even with product overload, investors are finding smart ways to use these indexes

**I**N THE TIME IT TAKES YOU to read this story, another exchange-traded fund probably will be launched in the U.S. More than 100 ETFs have been introduced this year, and the ever-expanding ETF universe is nearing 325 funds with more than \$350 billion in assets, according to Banc of America Securities. That's up from 102 funds and \$83 billion only five years ago. These ETFs range from the truly innovative—a currency fund pegged to the euro—to the fifth copycat biotech portfolio. The latest wave is funds based on fundamental indexing, an approach that has been attacked from some quarters (page 108). ¶ In case you've haven't been paying attention or need a refresher course, here's what you have to know: Most

ETFs are index funds that, unlike mutual funds, can be bought and sold through the trading day. Since they mimic indexes, their expenses are low, as little as 0.09% a year for a fund based on the Standard & Poor's 500-stock index. Expenses for international, sector, and specialty ETFs are much higher, but they're all far less expensive than the average 1.42% expense ratio on equity mutual funds. Barclays Global Investors dominates in the ETF universe, with more than 140 funds available under its iShares name.

Even with product overload, smart investors are discovering innovative ways to use these vehicles. "The ETF market is

evolving very rapidly," says Milton Balbuena, chief investment strategist at Contango Capital Advisors, a money management firm in Berkeley, Calif. "The evolution is making it easier to implement strategies that are more interesting and more sophisticated."

## REAL-WORLD HEDGES

AS ENERGY PRICES were rising last year, Alan Haft, a financial adviser in Boca Raton, Fla., thought he could use an ETF to help his clients in the chillier climes offset their expected higher heating bills. So in July he shifted 5% to 10% of their money into the iShares Dow Jones U.S. Ener-

gy Sector Index fund (IYE), whose holdings include ExxonMobil, Chevron and ConocoPhillips. Haft's clients took the position for five months, logging 10% after-tax gain. Haft is now exploring ways to use ETFs to hedge against falling real estate prices—short selling iShares Dow Jones U.S. Home Construction (ITB) homebuilders' index, for example. (To sell short, you borrow shares in anticipation that the price will fall and place the borrowed shares later at a lower cost.)

ETFs provide a way to hedge currencies, too. For example, if you are planning a trip to Italy next summer but you think the dollar will fall further against the euro by the time you embark, you can start some money in the new Euro Currency Trust (FXE). That, in effect, lets you lock in euros at today's prices.

## INVESTMENT HEDGES

EITHER THROUGH WORK or inheritance, some people end up with a huge chunk of their net worth tied up in a single stock. That's something Paul Coleman, managing partner at Wealth Planning Management, an advisory firm in Indianapolis, sees often with clients who work at nearby drugmaker Eli Lilly. "They n-





# Nest

BY LAUREN YOUNG

ver want to sell," Coan says. To protect them with some downside protection, he sells short an ETF that tracks the industry, usually in an amount 1 to 5% to 10% of the value of the fund's holdings.

Last summer, Eli Lilly fell 1%, while Amgen fell even more, and so the short position in PowerShares Dynamic Pharmaceuticals Portfolio (PJP) gained 3%. It has since shifted to the iShares U.S. Pharmaceuticals Index (IHE), which has a lower expense ratio.

The growing number of leveraged ETFs lets investors diversify their fixed-income investments.

Investors who are concerned about rising interest rates are eroding principal, Contango Capital's Balbuena says the portfolio with a corresponding ETF. For example, for a long-term bond portfolio, he sells short the iShares Lehman 20-year

Treasury Bond fund (TLT). If rates rise and the value of the bond portfolio declines, that loss will be partially offset by the shares sold short.

## MANAGING TAXES

WITH THE END of the year approaching, ETFs can be handy tools to help execute some tax-related strategies. Typically, investors take losses to offset other capital gains or generate write-offs even if they still believe in the investment. So if you're taking a loss in, say, Intel, you can replace your stock with an equal value investment in the iShares Goldman Sachs Semiconductor Index fund (IGW).

That preserves your stake in the industry just in case the sector takes a big leap forward. After all, if you buy back the stock before 31 days have passed, the Internal Revenue Service would bar you from taking the loss. So on the 31st day, you sell the ETFs and buy back the original holding. Jeff Layman, an adviser in Springfield, Mo., uses ETFs this way all the time. For clients with large Pfizer stakes, he substitutes the iShares Dow Jones U.S. Sector Healthcare fund (IYH).

## PLUGGING LOSSES

HERE'S A PLOY stock traders use that would be impossible with conventional mutual funds. Marc Collier, an adviser at Pinnacle Capital Management in Boston, had a client who was bullish on Chinese stocks but, recognizing their volatility,

wanted to limit his risk. So in April, 2005, Collier put \$25,000 of his client's \$900,000 portfolio into the iShares FTSE/Xinhua China 25 ETF (FXI) at about \$55 and set a stop-loss order at \$49. A stop-loss order lets you buy or sell a security when it hits a predetermined price.

As the ETF rallied, Collier raised the stop-loss trigger, always keeping it about 10% below the ETF's price. In May, 2006, the ETF hit \$80, but then it fell to \$73 in June, and that triggered a sale. "We gained about 33% on the [original] position, but were never at risk for a loss of more than 10%," Collier says.

## GETTING INTO COMMODITIES

COMMODITY ETFs zoomed in popularity, fueled mainly by their heavy weighting in energy. That raises a red flag for those who might invest in them. Right now, energy makes up about 75% of the iShares GSCI Commodity Indexed Trust (GSG) and half the PowerShares Deutsche Bank Commodity Index Tracking Fund (DBC) ETF. If you want gold or silver, better to invest in the ETFs dedicated to each.

A good alternative to these ETFs are exchange traded notes (ETNs), which are debt securities backed by Barclays Bank. When you buy an ETN, you get a promise from Barclays that your investment will match the index the ETN tracks (minus expenses), which a Morgan Stanley study found that one in five ETFs fails to do. The new ETNs are all on commodity indexes, but eventually others will be launched to track all sorts of indexes. ■

**BusinessWeek** **weekend** For more on investing in ETFs, watch *BusinessWeek Weekend*. Check your local listings or go to [businessweekweekend.com](http://businessweekweekend.com) to find out when it airs in your area.





# Battle for the Index Investor

A war of words is raging over how best to weight an index fund. At stake, lots of fees. **BY CHRISTOPHER FARRELL**

**N**OBEL LAUREATE William Sharpe has called indexing "a dull, boring way to be a better investor than many of your friends." Forget dull and boring. A civil war has broken out in academic journals, blogs, and op-ed pieces penned by the titans of indexing.

The upstart Fundamentalists say new, customized indexes based on metrics such as dividends, earnings, and book value—now available as exchange-traded funds (ETFs)—best traditional benchmarks like the Standard & Poor's 500-stock index and the Russell 1000. Quant guru Robert Arnott of Research Associates and Wharton School professor Jeremy Siegel, author of *Stocks for the Long Run*, are leading Fundamentalists. The Traditionalists, such as John Bogle, the founder of Vanguard Group, and Princeton University professor Burton Malkiel, author of *A Random Walk Down Wall Street*, are appalled by the Fundamentalists' claims. Siegel says that custom indexes reflect "a new paradigm" for understanding how markets

work. Bogle retorts: "The new things aren't indexes at all."

The dispute is arcane, infused with theoretical disagreements about modern portfolio theory. Still, it's a struggle over which indexes will earn investors the biggest return for the least risk and, of course, which companies will reap the rewards. Vanguard is the giant in traditional indexing, while Arnott's custom indexes are marketed by PowerShares Capital Management and others. Siegel is senior investment strategist for Wisdom Tree Investments, which also sponsors fundamental ETFs.

The details are in index construction. Traditional indexes like the S&P and Wilshire 5000 are capitalization-weighted, meaning the heft of each stock in the index is relative to the market value of its shares. In practice, that means the most

highly valued companies wield a proportionate influence on performance. These indexes can become lopsided: In the height of the dot-com era, technology stocks accounted for more than 30% of the index, about double its long-term average. That turned out to be a drag on returns when the bubble burst.

## MARKET MOOD SWINGS

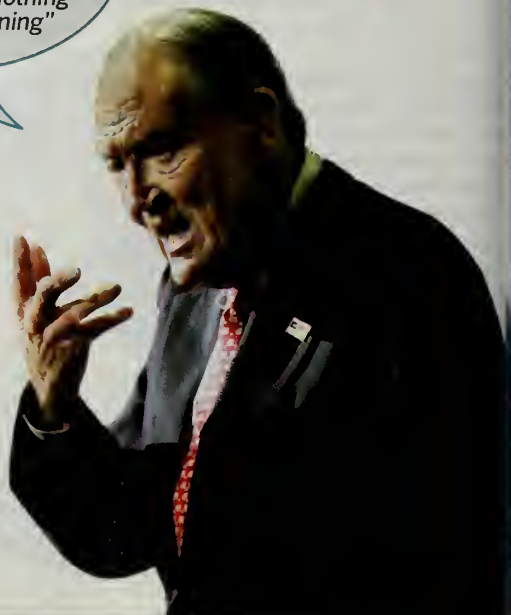
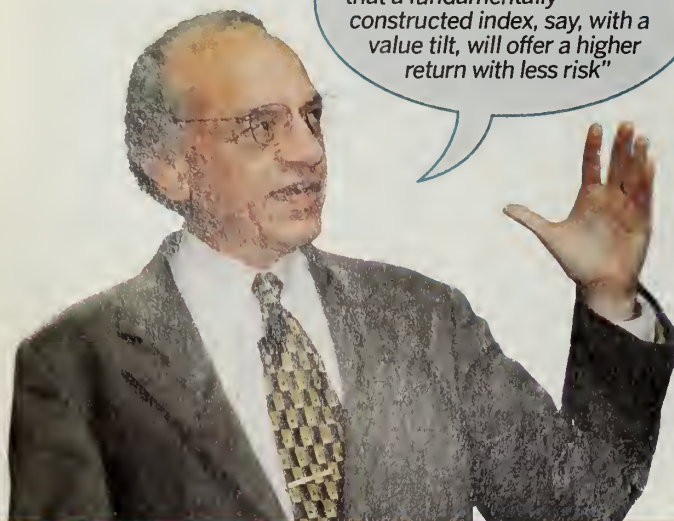
THE CAPITALIZATION-indifferent mentalist approach is less susceptible to market mood swings and comes closer to ranking companies on their importance to today's economy. For example, Vanguard's FTSE RAFI 1000 Portfolio places Wal-Mart Stores and General Motors in the top 10 holdings, though they are not as high in the S&P 500. Simulacrum and others suggest that the mental indexes beat the traditional ones about two percentage points a year over the long term. The Traditionalists argue that new indexes are benefiting from a market now favoring value and small-cap stocks.

A more compelling criticism is higher fees and trading costs. For instance, Vanguard's Total Stock Market ETF (VTI) sports annual expenses of 0.07%, while the Wisdom Tree Total Dividend Fund (DTD), based on dividends, has a 0.28% cost. PowerShares's FTSE US 1000, which weights stocks based on sales, income, dividend yield, and book value, costs 0.76%.

In the end, this argument may be a lot of hot air. Most investors have bought traditional index funds and actively managed mutual funds. Expenses of pricier ETFs are only half that of the average mutual fund. If fundamental indexes catch on, it could be at the expense of managed mutual funds and traditional indexers. ■

**VANGUARD'S JOHN BOGLE:** What troubles me is this talk of a new paradigm, a new wave of indexing replacing the old. It's based on nothing but data mining"

**WHARTON'S JEREMY SIEGEL:** "The overwhelming evidence is that a fundamentally constructed index, say, with a value tilt, will offer a higher return with less risk"





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| <b>Janus Contrarian Fund</b> <sup>4,5,8,9</sup> (2/00)            | <b>22.05</b> | <b>23.56</b> | <b>9.73</b>  | —            | <b>8.39</b>     |
| Russell 500 Index                                                 | 8.63         | 11.22        | 2.49         | —            | 0.46            |
| <b>Janus Adviser Forty Fund Shares</b> <sup>1,2,6,11</sup> (5/97) | <b>8.56</b>  | <b>14.09</b> | <b>4.12</b>  | —            | <b>12.33</b>    |
| Russell 1000 Growth Index                                         | 6.12         | 8.35         | -0.76        | —            | 4.05            |
| <b>Janus Orion Fund</b> <sup>4,8,10</sup> (6/00)                  | <b>24.65</b> | <b>21.57</b> | <b>9.58</b>  | —            | <b>-1.62</b>    |
| Russell 3000 Growth Index                                         | 6.84         | 8.96         | -0.43        | —            | -7.33           |
| <b>Janus Overseas Fund</b> <sup>3,4,5,7,8,12,13</sup> (5/94)      | <b>52.33</b> | <b>33.29</b> | <b>11.83</b> | <b>12.73</b> | <b>13.85</b>    |
| EAFE Index                                                        | 26.56        | 23.94        | 10.02        | 6.39         | 6.75            |

Performance presented reflects past performance, which is no guarantee of future results. Investment results and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Due to market volatility, current performance may be higher or lower than the performance shown. Visit [janus.com](http://janus.com) for performance current to the most recent month-end.

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Performance of Janus Adviser Forty Fund Shares commenced operations on 8-1-00 after the reorganization of the Retirement Shares of Janus Aspen Series into the Funds. Performance of Janus Orion Fund reflects the performance of the initial class of Janus Aspen Series. The performance shown reflects the fees and expenses of Class S shares. Performance may be affected by any fee and expense limitations or waivers. Janus Capital has contractually agreed to waive each Fund's total operating expenses (excluding the fund's administrative, distribution, and other expenses) to certain limits until at least the end of 2006. Total returns shown include fee waivers, if any, and without such waivers total returns would have been lower.

Performance does not guarantee that the investment process will consistently lead to successful investing.

For purposes of benchmarking, "since inception" returns are as of 4/30/97. For comparative purposes, benchmark "since inception" returns are as of 4/30/94.

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The Fund's performance may be affected by risks that include those associated with concentration and non-diversification in foreign securities and in companies that are undervalued or overlooked companies.

The Fund's performance may be significantly impacted by investing in initial public offerings (IPOs) and due to "market" volatility in the high-tech sector and financial sector. The Fund's performance over the last 3 months or less. Performance shown does not reflect this redemption fee and, if reflected, performance would have been lower.

The Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The Russell 3000 Growth Index measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values.

The EAFE Index is a broad-based, unmanaged index of common stock prices. The Morgan Stanley Capital International EAFE Index is a market capitalization weighted index of common stocks representative of the market structure of Developed Market countries (Europe, Japan, and Australia).

Janus Adviser Forty Fund Shares is a Janus Fund.

Janus Adviser Forty Fund Shares is a Janus Fund.





BY MARA DER HOVANESIAN

**IF GOODYEAR SETTLES A NEW LABOR PACT, SHARES MAY BOUNCE STRONGER RESULTS COULD LIE AHEAD FOR STEEL DYNAMICS. WHY THE WORRIES AT NEUROMETRIX MAY BE EXAGGERATED.**

## Goodyear: Ready to Roll?

INVESTORS IN Goodyear Tire & Rubber (GT) face a rough ride as the Akron company struggles with the United Steelworkers over retirement and health benefits. Ever since labor contracts expired in July, negotiations have been deadlocked. Conventional wisdom is that a strike is imminent, and the stock, now at 14.70, will hit the skids. But some analysts think Goodyear has the advantage, and they advise riding out the volatility. That's because the company is aggressively outsourcing production to Latin America and Asia. "Right now they are at an impasse, but they can tell the union to buzz off," says Ivan Feinseth of Matrix USA, a New York research shop. "The biggest leverage a manufacturing company has is the ability to outsource." The stock, says Feinseth, is "easily" worth 18. "If they get a deal, the stock is going to rip," agrees William Smith of Smith Asset Management in New York, who owns 48,000 shares and expects the stock to hit 20. Smith says cheaper oil and raw materials will boost the bottom line, although there is a risk that recent price declines are temporary. Restructuring has already helped Goodyear beat Wall Street's second-quarter estimates. Net income was \$2 million for the three months ended June 30—way below last year's figure of \$69 million. Sales inched up from \$5 billion to \$5.1 billion. Smith figures plant closings will make next year's earnings pop to \$1.95 a share, rather than current estimates of \$1.40.



## Reinforced with Cash At Steel Dynamics

STEEL DYNAMICS (STLD) has been hammered in the past six months as mounting inventories and falling scrap prices have hit the consolidating industry. The 49.85 stock is down from its May 11 high of 69.95. But a rebound for the No. 4 U.S. steelmaker may be coming. The Fort Wayne (Ind.) company says its free cash flow could top \$350 million this year, enough for additional share buybacks. That could also fund \$255 million for new plants and upgrades next year, 80% more than in 2005. Timna Tanners of UBS adds in a new report that "recent underperformance and its cash could pique a buyer's interest." Strong third-

quarter earnings and another buyback program of 5 million shares will boost EPS. Moreover, the American Iron & Steel Institute reported on Sept. 18 that steel prices reached an 18-month high in July and that steel shipments rose 16% as demand from automakers and builders increased. Both Tanners and Mark Parr of McDonald Investments, a unit of Cleveland's KeyCorp., see the stock reaching 80 in 12 months.



## Calm Those Fears About NeuroMetrix

AFTER NEUROMETRIX (NURO) received inquiries about its marketing tactics, rumors of possible federal indictments pummeled the stock. The company, which disclosed the subpoenas voluntarily, doesn't expect further action. The Waltham (Mass.) startup sells devices to diagnose carpal tunnel syndrome and ills associated with back pain and diabetes. More than 4,000 of the units are in use at general practitioners' offices. The stock, priced at 8 in its July, 2004, initial public offering, surged to 40 in May but has fallen to 21.44, as the shorts piled in (43% of the shares have been shorted). "The [alleged] fraud is not substantiated; this stock is manipulated by the shorts," says Ryan Rauch of investment firm Jefferies. In a Sept. 19 report, William Quirk of RBC Capital Markets added: "Concerns are largely based on false information." Quirk says the stock is worth 50. There's fear in the market about the stock, says David Turkaly of Susquehanna Financial Group. Of course, he adds, "the [NeuroMetrix] technology is pretty disruptive, and the neurology community is unhappy because it sidesteps the specialist." NeuroMetrix was profitable five quarters after IPO. For this year, Turkaly forecasts a 63% increase in revenue to \$55.8 million, and profits of \$4 million (or \$7 million, before stock option expenses). ■

—Gene Marcial is on vaca



**BusinessWeek online** Gene Marcial's Inside Wall Street is posted at [businessweek.com/investor](http://businessweek.com/investor) at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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**United  
Technologies**

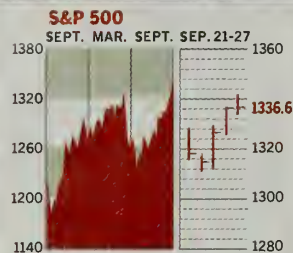
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and to the SEC periodically.



## STOCKS



### COMMENTARY

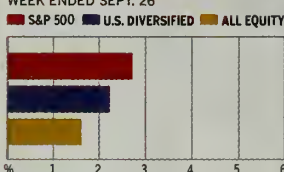
Save that bubbly for another day. Although the Dow gained nearly 1% for the week, it fell just short of its all-time high thanks chiefly to a snap-back in oil prices. Energy stocks led the way, with Occidental Petroleum and Marathon Oil up more than 7% each for the week. Drug-related shares were the big losers. The week saw the S&P 500 and NASDAQ rise, too.

Data: Bloomberg Financial Markets, Reuters

## MUTUAL FUNDS

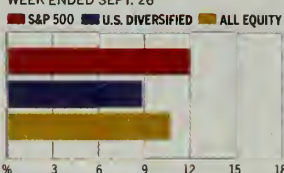
### 4-WEEK TOTAL RETURN

WEEK ENDED SEPT. 26



### 52-WEEK TOTAL RETURN

WEEK ENDED SEPT. 26



Data: Standard & Poor's

## U.S. MARKETS

|                       | SEPT. 27 | WEEK | % CHANGE<br>YEAR TO<br>DATE | LAST 12<br>MONTHS |
|-----------------------|----------|------|-----------------------------|-------------------|
| S&P 500               | 1336.6   | 0.9  | 7.1                         | 9.9               |
| Dow Jones Industrials | 11,689.2 | 0.7  | 9.1                         | 11.8              |
| NASDAQ Composite      | 2263.4   | 0.5  | 2.6                         | 6.9               |
| S&P MidCap 400        | 758.2    | 0.6  | 2.7                         | 7.7               |
| S&P SmallCap 600      | 376.2    | 0.0  | 7.3                         | 8.7               |
| DJ Wilshire 5000      | 13,339.2 | 0.7  | 6.7                         | 9.9               |

## SECTORS

|                      | SEPT. 27 | WEEK | % CHANGE<br>YEAR TO<br>DATE | LAST 12<br>MONTHS |
|----------------------|----------|------|-----------------------------|-------------------|
| BusinessWeek 50*     | 754.9    | 1.2  | 1.8                         | 1.1               |
| BW Info Tech 100**   | 407.4    | 0.6  | 7.1                         | 12.5              |
| S&P/Citigroup Growth | 620.9    | 0.8  | 4.1                         | 6.8               |
| S&P/Citigroup Value  | 713.6    | 1.0  | 10.2                        | 13.3              |
| S&P Energy           | 409.6    | 4.9  | 9.9                         | 1.3               |
| S&P Financials       | 465.3    | 0.6  | 9.1                         | 18.3              |
| S&P REIT             | 184.2    | 0.0  | 20.3                        | 22.4              |
| S&P Transportation   | 256.3    | 1.6  | 2.6                         | 18.2              |
| S&P Utilities        | 174.7    | 2.3  | 9.4                         | 4.4               |
| GSTI Internet        | 174.4    | 1.7  | -15.0                       | -0.3              |
| PSE Technology       | 830.2    | 0.0  | -0.7                        | 3.8               |

\*Mar. 19, 1999=1000 \*\*Feb. 7, 2000=1000

## GLOBAL MARKETS

|                             | SEPT. 27 | WEEK | % C<br>YEAR T<br>DATE |
|-----------------------------|----------|------|-----------------------|
| S&P Euro Plus (U.S. Dollar) | 1791.9   | 1.2  | 18.1                  |
| London (FT-SE 100)          | 5930.1   | 1.1  | 5.1                   |
| Paris (CAC 40)              | 5243.1   | 1.0  | 11.1                  |
| Frankfurt (DAX)             | 5989.7   | 0.6  | 10.1                  |
| Tokyo (NIKKEI 225)          | 15,947.9 | 1.5  | -1.1                  |
| Hong Kong (Hang Seng)       | 17,521.5 | 0.0  | 17.1                  |
| Toronto (S&P/TSX Composite) | 11,751.6 | 1.0  | 4.1                   |
| Mexico City (IPC)           | 21,748.6 | -0.4 | 22.1                  |

## FUNDAMENTALS

|                                      | SEPT. 26 | WEEK AGO |
|--------------------------------------|----------|----------|
| S&P 500 Dividend Yield               | 1.82%    | 1.84%    |
| S&P 500 P/E Ratio (Trailing 12 mos.) | 17.6     | 17.4     |
| S&P 500 P/E Ratio (Next 12 mos.)*    | 14.7     | 14.4     |
| First Call Earnings Revision*        | -0.39%   | -0.80%   |

## TECHNICAL INDICATORS

|                                       | SEPT. 26 | WEEK AGO |
|---------------------------------------|----------|----------|
| S&P 500 200-day average               | 1281.8   | 1280.2   |
| Stocks above 200-day average          | 57.0%    | 53.0%    |
| Options: Put/call ratio               | 0.87     | 0.81     |
| Insiders: Vickers NYSE Sell/buy ratio | 3.68     | 3.46     |

## BEST-PERFORMING GROUPS

|                          | LAST MONTH % |                          | LAST 12 MONTHS % |
|--------------------------|--------------|--------------------------|------------------|
| Tires & Rubber           | 20.4         | Steel                    | 65.5             |
| Genl. Merchandise Chains | 18.8         | Agricultural Products    | 59.9             |
| Computer Retailers       | 17.5         | Fertilizers & Ag. Chems. | 57.3             |
| Home Furnishings Rtlrs.  | 17.3         | Intgrd. Telecomms. Svcs. | 35.8             |
| Automotive Retailers     | 15.9         | Divsfd. Metals & Mining  | 34.9             |

## WORST-PERFORMING GROUPS

|                       | LAST MONTH % |                      | LAST 12 MONTHS % |
|-----------------------|--------------|----------------------|------------------|
| Coal                  | -19.7        | Homebuilding         |                  |
| Gold Mining           | -17.8        | Educational Services |                  |
| Oil & Gas Refining    | -17.2        | Internet Retailers   |                  |
| Oil & Gas Equip.      | -10.0        | IT Consulting        |                  |
| Agricultural Products | -9.6         | Wireless Services    |                  |

## EQUITY FUND CATEGORIES

| 4-WEEK TOTAL RETURN | %    | 52-WEEK TOTAL RETURN    | %    |
|---------------------|------|-------------------------|------|
| <b>LEADERS</b>      |      | <b>LEADERS</b>          |      |
| Communications      | 4.6  | Precious Metals         | 34.5 |
| Technology          | 4.2  | Latin America           | 27.2 |
| Financial           | 4.0  | Real Estate             | 25.8 |
| Large-cap Growth    | 2.6  | Diversified Emrg. Mkts. | 21.8 |
| <b>LAGGARDS</b>     |      | <b>LAGGARDS</b>         |      |
| Natural Resources   | -7.6 | Natural Resources       | 2.6  |
| Precious Metals     | -7.3 | Health                  | 3.8  |
| Japan               | -3.3 | Small-cap Growth        | 5.6  |
| Latin America       | -1.6 | Large-cap Growth        | 5.9  |

## EQUITY FUNDS

| 4-WEEK TOTAL RETURN            | %     | 52-WEEK TOTAL RETURN       | %     |
|--------------------------------|-------|----------------------------|-------|
| <b>LEADERS</b>                 |       | <b>LEADERS</b>             |       |
| DireXn. NASDAQ 100 BL 25X Inv. | 13.0  | U.S. Global Invrs. Gold    | 55.6  |
| iShares D.J. U.S. Bkr. Dirs.   | 11.7  | Midas                      | 50.6  |
| ProFds. Sh. Prc. Mtls. Inv.    | 11.5  | U.S. Gbl. Invrs. Prc. Mnl. | 50.0  |
| ProFunds UltraOTC Inv.         | 10.4  | Van Eck Invrs. Gold A.     | 49.2  |
| <b>LAGGARDS</b>                |       | <b>LAGGARDS</b>            |       |
| ProFunds Prc. Mtls. Inv.       | -16.8 | American Heritage Grth.    | -50.0 |
| Rydex Commodities H            | -13.2 | Rydex Commodities H        | -23.7 |
| PFds. Oil Equip. Serv. Inv.    | -12.8 | American Heritage          | -22.2 |
| U.S. Gbl. Invrs. Prc. Mnl.     | -12.3 | Merrill Lynch RI. Invmt. C | -22.2 |

## INTEREST RATES

### KEY RATES

|                          | SEPT. 27 | WEEK AGO |
|--------------------------|----------|----------|
| Money Market Funds       | 4.84%    | 4.84%    |
| 90-Day Treasury Bills    | 4.88     | 4.92     |
| 2-Year Treasury Notes    | 4.69     | 4.82     |
| 10-Year Treasury Notes   | 4.60     | 4.73     |
| 30-Year Treasury Bonds   | 4.74     | 4.85     |
| 30-Year Fixed Mortgage † | 6.05     | 6.20     |

## BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

|                       | 10-YR. BOND | 30-YR. BOND |
|-----------------------|-------------|-------------|
| General Obligations   | 3.74%       |             |
| Taxable Equivalent    | 5.34        |             |
| Insured Revenue Bonds | 3.86        |             |
| Taxable Equivalent    | 5.51        |             |

## THE WEEK AHEAD

### PURCHASING MANAGERS' INDEX

Monday, Oct. 2, 10 a.m. EDT

» The Institute for Supply Management's September factory activity index has probably eased back to 53.5%. That's the median forecast of economists surveyed by Action Economics. In August the index edged down to 54.5%.

### CONSTRUCTION SPENDING

Monday, Oct. 2, 10 a.m. EDT

» August building outlays are forecast to have rebounded 0.2%.

July spending fell 1.2% on a big drop in residential construction.

### VEHICLE SALES Tuesday, Oct. 3

» September sales of light vehicles most likely improved to an annual rate of 16.5 million units, according to WardsAuto.com. August sales slowed to a pace of 16 million vehicles.

### FACTORY INVENTORIES

Wednesday, Oct. 4, 10 a.m. EDT

» Manufacturing inventories probably rose 0.3% in August.

### EMPLOYMENT Friday, Oct. 6,

8:30 a.m. EDT » Nonfarm payrolls in September most likely rose by 125,000 workers, after an August gain of 128,000 jobs. The jobless rate is expected to have held at 4.7%, while hourly earnings most likely rose 0.3%.

### INSTALLMENT CREDIT Friday,

Oct. 6, 3 p.m. EDT » In August

consumers probably took on \$4 billion more of debt, after an increase of \$5.5 billion in July.

The BusinessWeek production index edged out a small gain to 284.8 last week ended Sept. 16, an 11.1% increase from the previous year. In the calculation of the four-week average, the index held at 284.8.

## BusinessWeek

For the BW50, more investment data, and the components of the production index visit [www.businessweek.com/extras](http://www.businessweek.com/extras)



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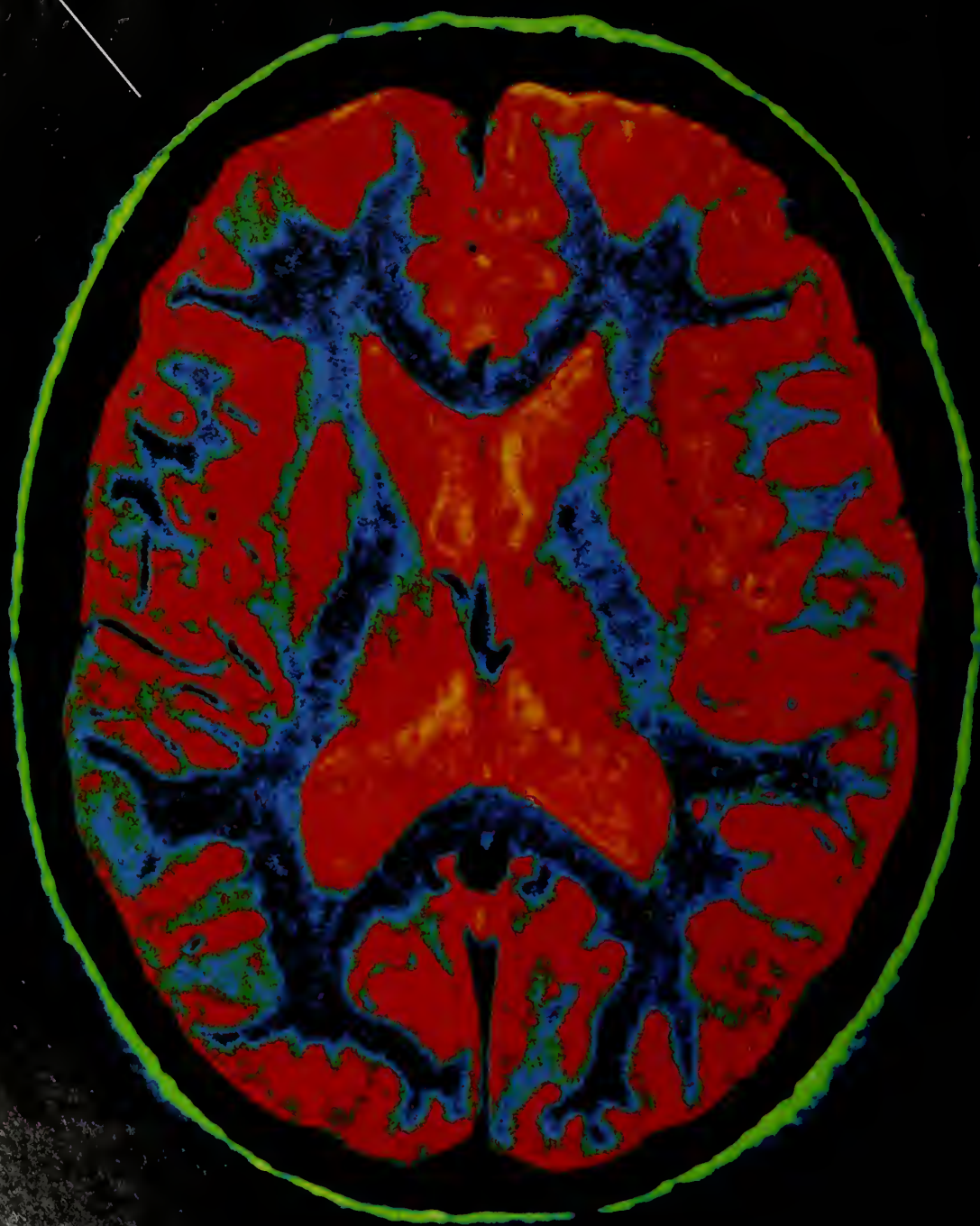
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# The World, Two Blueprints

## GLOBALIZATION WORK

Joseph E. Stiglitz; Norton; 358pp; \$26.95

## THE NEXT GREAT GLOBALIZATION

Frederic S. Mishkin; Princeton; 310pp; \$27.95

Economists Joseph Stiglitz and Frederic Mishkin often walk past each other: They have offices on the same hallway at Columbia University. At first, they seem to walk past each other as well. In two books on globalization, the liberal

devotes most of his space to attacking trade deals that barely considers, while Establishment-figure Mishkin's big bank reform—doesn't get a single sentence in Stiglitz' book. In fact, Stiglitz and Mishkin are grappling with the same question, which is how to make globalization work better for the world's poor. But they come at the problem from different directions and reach different conclusions. In

*Globalization Work*, Stiglitz debates the debate in moral terms, arguing that as the richest and most powerful nation the U.S. has a duty to make poor nations better. Mishkin, the technocrat in *The Next Great Globalization*, contending that reforms in poor nations' banking systems would help them enjoy the fruits of globalization. Despite their different approaches, their arguments aren't mutually exclusive. Both authors offer valuable ideas.

Like two professors, Stiglitz has a bigger name. Formerly President Bill Clinton's top economic adviser, he went on to become chief economist of the World Bank, left after a power struggle with Treasury Secretary Lawrence Summers, won a Nobel prize, and wrote an unlikely international best seller, the angry, angry *Globalization and Its Discontents*. Now he travels the world advising foreign governments and organizations. It's easy to see why Stiglitz has a larger following outside the U.S. than in it, because his overarching theme is blaming globalization for the world's ills. He has kind words for the protective policies of "charismatic" Venezuelan President Hugo Chávez. He says Wall Street's short-term perspective is "antithetical to development" in poor countries and that the U.S.-led agreement to enforce drug patents was "a warrant" to sick people in poor countries. He argues that poor countries have a right to put punitive tariffs on U.S. goods because the U.S. is effectively subsidizing its exports by not forcing them to take action against global trade. And he concludes the book by charging that the system has undermined global democracy."

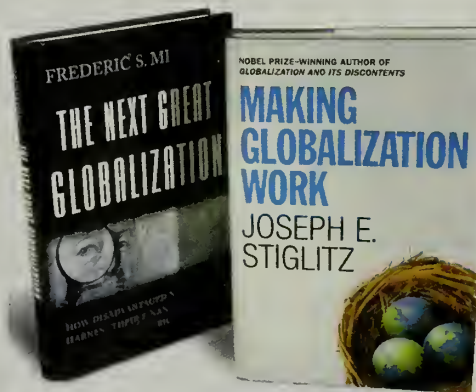
But you don't have to agree with Stiglitz on every point to benefit from his creative thinking. His most intriguing idea, which borrows from John Maynard Keynes, is the creation of an international reserve currency that countries would hold in their rainy-day funds instead of gold and dollars. Today, the dollars they hold, primarily in Treasury securities, amount to a loan to the U.S. "There is something peculiar," Stiglitz writes with undeniable logic, "about poor countries desperately in need of capital lending hundreds of billions of dollars to the world's richest country." The benefit of his proposal for the U.S.: If other countries didn't need to accumulate dollars, they could spend them on U.S. goods and services, shrinking America's trade deficit, which is so big it threatens to trigger a dollar crash. Where Stiglitz goes off track is in imagining that these new reserves could be handed out to needy countries rather than earned—making the whole thing into a vast system for transferring wealth.

Mishkin's book, while narrower in its prescriptions, is ambitious in its own way because it defends the one aspect of globalization that has the fewest defenders: free flows of capital across borders. Even many economists who strongly favor unfettered trade in goods and services (such as a third Columbia professor, Jagdish Bhagwati) worry that unrestrained cross-border investment will cause bubbles and crashes in developing countries with underdeveloped financial systems. But Mishkin is a staunch free-market guy—and, since he finished the book, a powerful one.

As a new member of the Federal Reserve Board of Governors, he votes on whether to raise or lower the federal funds rate (so blame him when your ARM resets). *The Next Great Globalization* describes the failings of the International Monetary Fund well, in part a result of Mishkin's experience as an outside evaluator of the organization.

Mishkin has a plan for fixing banking systems that he says would enable them to put rapid inflows of capital to good use. One idea: Stop developing-country banks from borrowing in dollars, an enticing practice that backfires when the local currency depreciates. Rich countries can help with reforms, Mishkin says, but "disadvantaged countries must take responsibility for their own fates." While Stiglitz nods in the same direction, he puts most of the onus on the U.S., saying, "the time will come when the United States cannot do whatever it wants." One Ivy League hallway, two views of the world: No wonder the globalization debate is so intractable. ■

—By Peter Coy



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## Inside the HP Case

**VIET DINH** represents Tom Perkins, the venture capitalist and former Hewlett-Packard director who ignited the scandal still burning in Silicon Valley. But he's far more than a rich man's lawyer. Dinh, who came to America in 1978 as a 10-year-old immigrant from Vietnam, is a distinguished legal scholar and former Assistant Attorney General in the Bush Administration. He is generally credited with authoring the controversial USA Patriot Act.

### How did you first learn of the spying at HP?

Tom Perkins approached me at a News Corp. dinner and asked me for advice. [Both Perkins and Dinh are on the News Corp. board.] He laid out a rather dramatic tale about how he had just resigned from HP in protest over an investigation that Pattie Dunn had instigated in order to uncover contacts between her directors and reporters. My first reaction was that it was inconceivable for a board chairperson to spy on her directors. Then I said to Tom: "I simply cannot see how this could have been done legally."

### In CEO Mark Hurd's first public statement on Sept. 22, he said this board has had a history of leaks. Why is that?

I cannot even begin to understand or portray to you the dysfunctionality of this board. In law there is a phrase called *res ipsa loquitur*...Latin for "the thing speaks for itself"...The actions of the board over the past several years speak too much about itself, and what [they say] is not very pleasant. The CNET.com article that was supposedly the trigger for all of this intrigue is amazing because it is, if anything...banal, and frankly very favorable to HP. It would have worked to enhance the board rather than detract from it. So for the article to trigger the overreaction of Dunn is perplexing to me. It really is a benign puff piece.

### Have you spoken to Hurd since his statement?

I have. And without disclosing the contents of the conversation, I believe him when he says, to the investing community and

the company, that he is genuinely contrite about HP's a in which I believe he had minimal involvement. I have confidence, as does Tom Perkins, that Hurd is the right for HP, especially at this time, because his steady hand guide this board and the company back to a position of leadership.

### Do you have any sense of how widespread snooping on employees or even journalists is in Corporate America?

Not as a general matter, but my phone has been ringing quite steadily since the publicity about HP—matters re to pretexting and spying on competitors. I don't know I credible these inquiries are, but I think the silver lining episode is that everyone in Corporate America is on not that this type of activity has no place in our country, and of all in corporate leadership.

### You mean rival companies to HP are calling you?

Well, some rival companies, but more so other companies unrelated to HP who think competitors have been spying o them. They also are worried about pretexting their employe

### Given the damage that the scandal has done to HP's repu do you think Tom Perkins has any regrets?

No, I think the setback to HP's reputation is temporary. Per has been steadfast in saying "this too will pass."

### Perkins is gone, Director George Keyworth is gone, I gone. Will there be more casualties of the scandal?

It is really up to the prosecutors...but I suspe given the depth of activity and reach of the investigation, some other folks will have to be some responsibility for their actions.

### You're widely considered the chief architect of the Act. Do you see any irony that you are a voice of out over alleged privacy violations at HP?

No. There is a distinct difference bet the government using its po subpoena and search war to protect America again security threats and priv citizens and companies breaking the law in orde pursue their own intere and personal agendas.

Maria Bartiromo is the of CNBC's Closing Bell.



**DINH** "This type of activity has no place in our country"

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# Ideas **The Welch Way**

BY JACK AND SUZY WELCH

## Whose Company Is It Anyway

**Who is a company for—not legally speaking, but philosophically? Some people say it belongs to the shareholders, others to its employees. Still others say a company exists for its customers' sake. What do you think?**

—Tomohiro Horibe, Saitama, Japan

A company is for its shareholders. They own it. They control it. That's the way it is, and the way it should be.

Don't take our bluntness wrong; your question is hardly a no-brainer. In fact, it's at the heart of an ongoing public policy debate about corporate ownership, or more broadly put, about "voice."

The voice debate is complex and contentious—we can hear the Political Correctness Police revving their engines right now! The reason is that so many activist groups make the case for a say in company policy. Labor leaders, for instance, will tell you that businesses can't run without their people, yet they earn far less than executives. Shouldn't workers get a bigger piece of the action to correct that inequity? Elected officials will talk about a company's toll on local residents—clogged traffic, pollution, and depressed housing values. Shouldn't the community get some form of reparations for damage done? Social activists cite the responsibility of the strong and powerful to help the weak and less fortunate. Shouldn't a company honor that moral code?

Yes, yes, and yes—in principle.

But the problem is that many of those voices, however legitimate, have hidden agendas that often have little to do with the reality of what a company does.

Union organizers routinely denounce companies, regardless of their actual labor practices, as part of a never-ending campaign to increase membership and fatten coffers. As for politicians, vilifying what appears to be a big, rich enemy can be a fast way to generate publicity even if the object of the attack happens to be creating jobs and pouring tax receipts into the community. Social activists often target companies to draw attention to and raise money for their causes on the cheap: One or two professional protesters can easily create a shareholder-meeting fracas and a little fodder for the media.

Given all the agendas swirling around, companies can wind up in a real mess if they start reacting to the varied stakeholders who claim a piece of the company. That doesn't mean they shouldn't listen to these groups. Companies live or die because of engaged employees and satisfied customers.

Obviously, both have to be heard. Finally, companies in communities, are part of society, and must accept the responsibilities of good citizenship.

Capitalism, with its shareholder owners, reinforces that. Why? Because capitalism is based on the principle that shareholders want their companies to be profitable over the long haul. And sustained profitability leads to the outcomes we just mentioned: satisfied customers, engaged employees, thriving communities, and healthy societies.

**CAPITALISM'S CRITICS** like to point out that some companies don't give a whit about capitalism's fundamental principles. They argue that management wants maximum returns. Forget 10 years from now. And so companies squeeze the life out of their employees or destroy the environment (commit any number of other social crimes) to get fat and fast. To compound matters, detractors say, many companies pay executives ridiculous sums to deliver short-term results, or even worse, lousy performance. Human greed, they say, is a mighty flaw in the capitalist system.

Another increasingly prominent criticism of capitalism concerns shareholders who buy stock and flip it. It is said that this constituency, comprised largely of investment funds of all stripes, couldn't care less about long-term growth and profitability.

But quick-hit investors don't just rile up companies; they denounce them, too. Witness the current debate over whether there should be a defined holding period before voting rights are granted. A holding period may indeed invite some criticism on this particular front, but it will always be agenda-driven groups who

are against capitalism.

Sure, capitalism has its shortcomings. It also has plenty of virtues, one of which is that those same critics, with stated and veiled agendas have their voices heard in the marketplace and (loud and clear) in the media. But voice is not ownership. It is influence.

Ultimately, the legal and philosophical answers to your question are one and the same. A company exists to serve the people who elect the board of directors, which, in turn, picks the management that drives the company. It is for its owners.

*Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at [thewelchway@businessweek.com](mailto:thewelchway@businessweek.com). For their weekly podcast, go to [www.businessweek.com/search/podcasting.htm](http://www.businessweek.com/search/podcasting.htm)*



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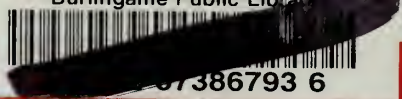
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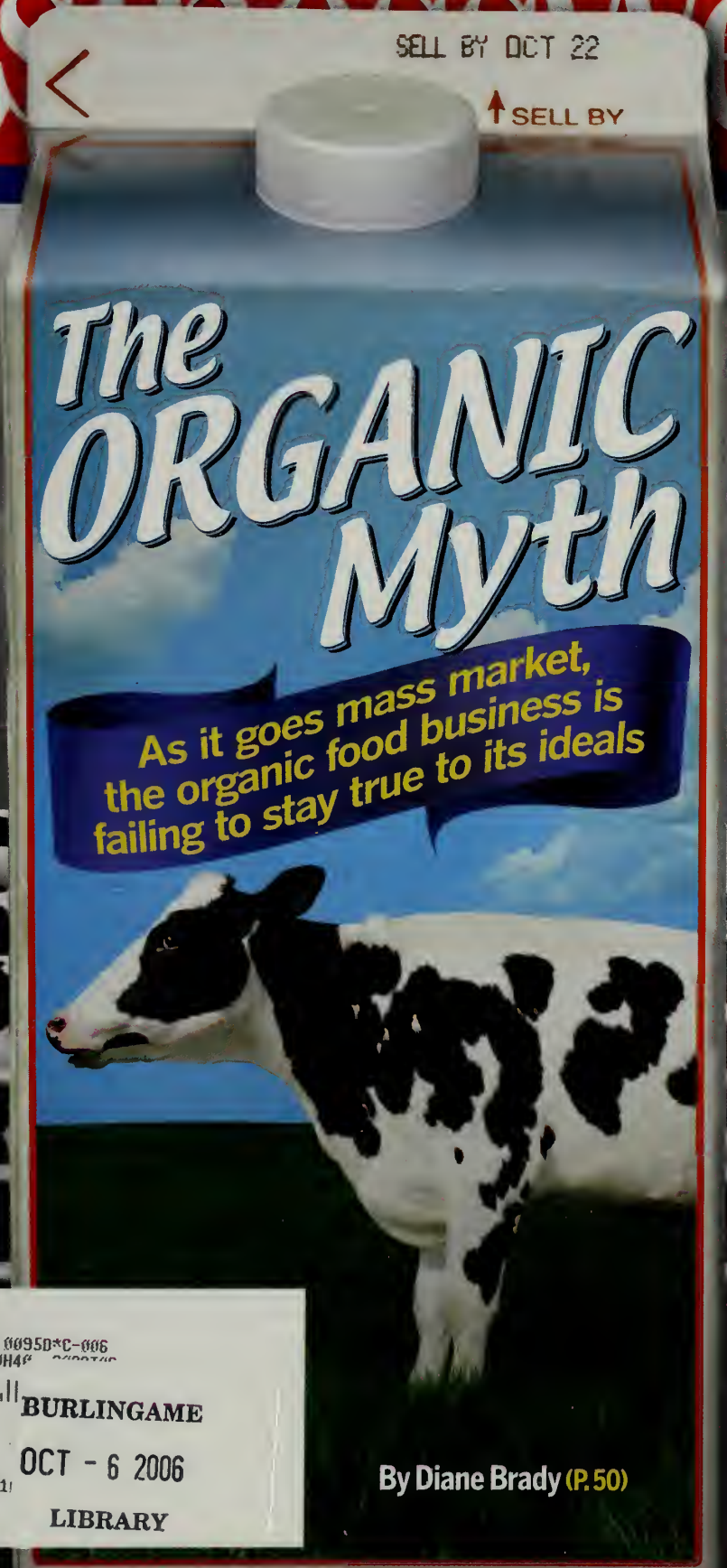
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## The ORGANIC Myth

As it goes mass market,  
the organic food business is  
failing to stay true to its ideals



By Diane Brady (P.50)

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LIBRARY



On his way to work,  
Brian started to think  
about how changing  
applications could  
dramatically speed  
up product design.

Right after that, a  
server overheated  
and he spent the day  
shopping for fans.

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# BusinessWeek

## The Business Week

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How pokes into the clouds; comments at HP; woes at Airbus; GM to Renault; and more

### Views: & Insights

#### Arrah's: A Bid Too Far?

es through, the takeover play from and Texas Pacific would be the -largest LBO ever. But Wall Street to think it won't

#### ine vs. iPod

Microsoft's music machine, set to t on Nov. 14, stacks up against the al

#### ie Sheiks Don't Shriek

ren't the Saudis dismayed by % drop in oil prices since July? se they secretly feared the ity a loftier market would bring

#### o Bush Left Behind

resident's brother Neil is making m school reform with his new t, a high-tech teacher's helper he "curriculum on wheels"

## Social Report

### delity's Divided Loyalties

utual fund giant could be the king eholder rights, but it has remained idelines as its peers have pushed ter governance. Are its corporate ts getting in the way?

## Innovation

### AW's Dream Factory

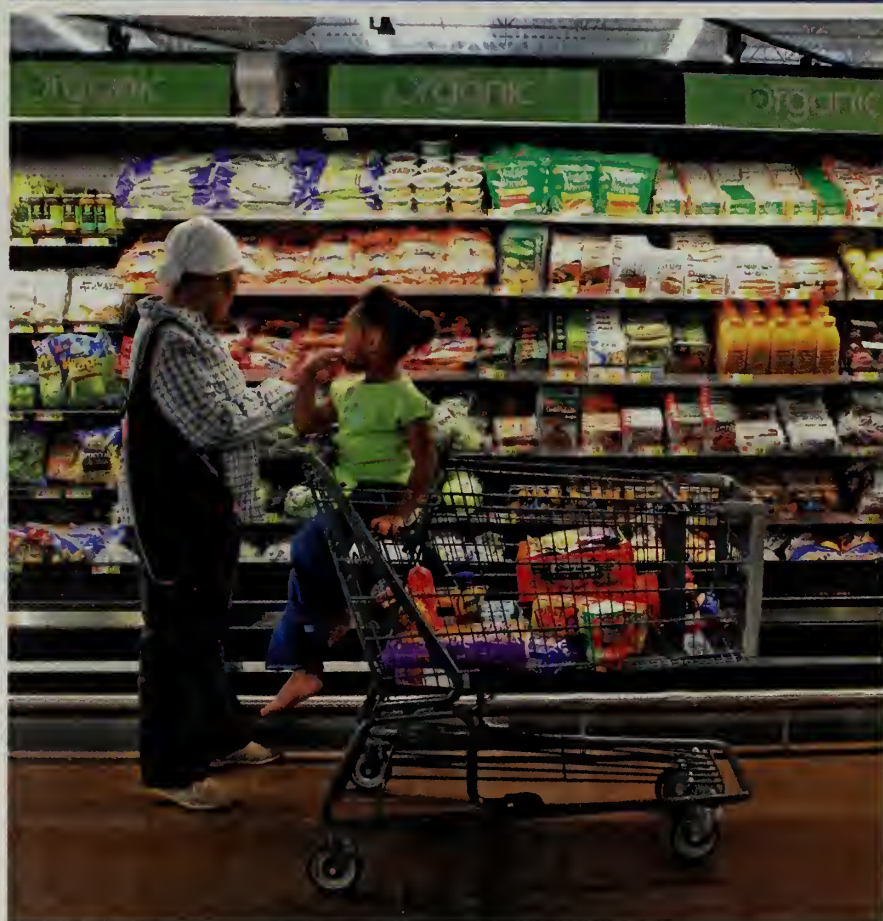
ing the wealth, listening to even the e-ranking workers, and rewarding ave paid off big-time

### Role Model for the Team Player

CEO Norbert Reithofer is an expert ding informal networks

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## Cover Story

**50 The Organic Myth** Contented cows ambling through meadows? Family farms turning out artisanal yogurt flavored with strawberries from over the fence? Forget it. As giants from Wal-Mart to Kellogg's get into the game, the pastoral ideal is being trampled—even for some of the most hallowed names in the business



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During his three-year reign at Citigroup, CEO Chuck Prince has brought rogue bankers under control and tidied up the bank to please regulators. So are investors happy? Hardly. With the stock stagnant for six years and profits less than sparkling, they're agitating for change. Prince says he gets the message





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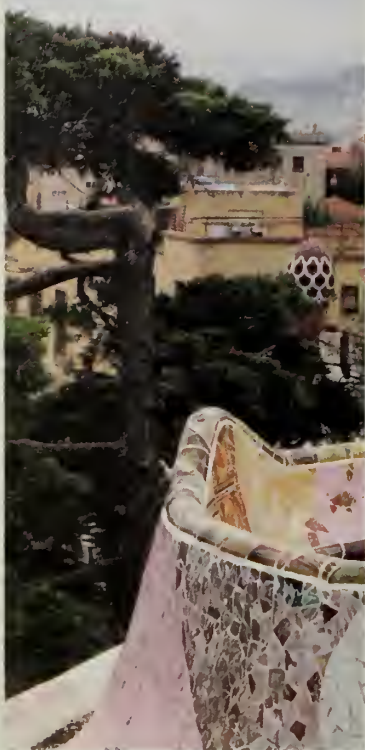
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The Volkswagen  
GX3 three-wheel  
concept car

## Take a Ride on the Tech Side

People buy cars for any number of reasons—price, reliability, status, appearance, fuel economy. But most drivers don't think about the underlying technology that governs everything from how fast their car goes to how much gas it consumes to how expensive it is. In our Special Report, **High Tech Cars**, BusinessWeek.com looks at the past, present, and future of automotive technology. How has the passenger car evolved? Our **historical timeline** ranges from the invention of the windshield wiper to the advent of the OnStar navigation system. Even though we're still a long way from flying cars and decent fuel economy, there are many **sophisticated technologies** available today that do everything from helping us drive better at night to avoiding traffic jams. In the future, drivers can expect to encounter such **Jetson-like devices** as DNA recognition software, on-board computers, and perhaps even a car that really does soar. For these features and more go to:

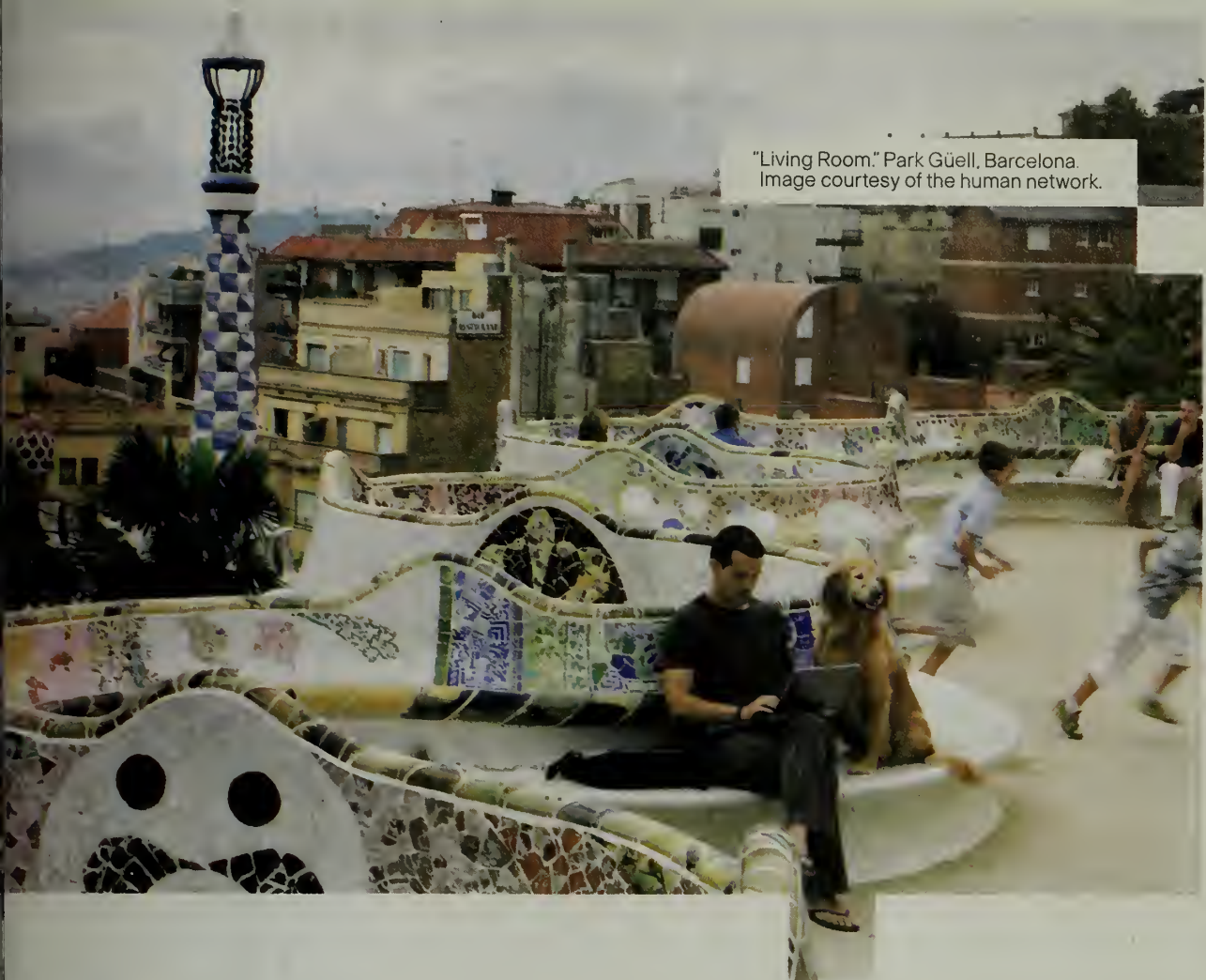
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"Living Room." Park Güell, Barcelona.  
Image courtesy of the human network.

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minute. Movies appear wherever there's a screen handy. And  
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networks are making us smarter, better and faster. Welcome  
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The story continues at [cisco.com/humannetwork](http://cisco.com/humannetwork).

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1987

1993

1600

1200

800

400



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— Dow Jones Industrials

— NASDAQ Composite

See below for an explanation of this chart. Represents performance period 12/31/86 through 12/31/05.

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**"It would have potentially been a distraction to the current turnaround efforts."**

*General Motors Chairman and CEO Rick Wagoner, commenting on the end of the discussions with Renault-Nissan on a proposed alliance.*

ED BY DEBORAH STEAD

## GE FUNDS AY TOUGH, E MARKET LL LOVE IT

**ESN'T** pay to be nice, ending to one of the first surveys of hedge fund sm. The study found hostile exchanges with a company—for the sale of or for a new business—generate price increases of 5% to the first 20 of the

ion campaign. By last, friendly exchanges debt restructuring, ends, or governance "no significant" rise. When fund managers "just about more independence or board presentation without trying a business gy, that's when the

market is lukewarm," says Wei Jiang, associate finance professor at Columbia Business School, who co-authored the study with colleagues from Duke, University of San Diego, and Vanderbilt. The study focused on 2004-05 cases, 110 activist managers, 339 companies, and 374 events, about 40% of which involved a threat of a proxy contest, takeover, or lawsuit.



No evidence backed up CEO complaints that hedge fund activism destroys value or focuses

only on the short term. The study found most of the fund managers to be "value investors targeting companies they believe are undervalued based on financial statement statistics"—and companies with lots of cash, the most seductive draw for hedge funds. —Mara Der Hovanesian



## CASE STUDY

# Virtual World, Real Courtroom

**A PROPERTY DISPUTE IN SECOND LIFE**, the online universe where more than 800,000 "residents" socialize and invest real money in virtual land, businesses, and products, has wound up in a bricks-and-mortar court in Pennsylvania.

In the first lawsuit against Linden Lab, which owns Second Life, Marc Bragg, a former SL denizen, filed a case in a county Court of Common Pleas, contending that Linden Lab wrongly canceled a virtual land purchase he made earlier this year, keeping \$2,000 of his investment and expelling him from SL in a dispute over whether he violated auction rules. He wants his money back, his membership reinstated, and punitive damages.

The case raises broad questions about users' rights in such worlds, says Rebecca Nesson, a Harvard Law School instructor whose cyberlaw class periodically holds virtual meetings in Second Life. "I suspect if a court invalidates part of Linden Lab's user agreement, companies that run virtual worlds where residents have digital assets will take note," said Nesson, whose students are discussing the case. Second Life's terms of service say that the company can terminate accounts without cause and without refund. Linden Lab marketing director Catherine Smith declined to comment on the case, but added that the company "fully recognizes the legitimate rights of its residents to own, create, and sell property."

—Aili McConnon

## THE BIG PICTURE

**HOME OF** government incentives, environmentalists, and early adopters, California is the country in hybrid car sales. Some states at the head of the pack:

SHARE OF U.S. HYBRID CAR REGISTRATIONS\*  
SHARE OF U.S. TOTAL CAR REGISTRATIONS\*

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|------------|---------|-------|----------|
| 6.4%       | 5.1%    | 5.0%  | 4.7%     |
| 2.8%       | 8.5%    | 7.6%  | 5.2%     |

Data: R.L. Polk & Co.; Automotive News



## WILD IDEAS

### AND ON HIS FARM HE HAD A TIGER

ONLY ABOUT 5,000 tigers live in the wild, despite strenuous international efforts to stop poachers, who sell tiger skins, whiskers, claws, penises, and other body parts



for decoration, medicines, and aphrodisiacs.

Washington is amping up the pressure on India and China to stop this illicit business, saying that countries not doing enough to combat the trafficking in tiger parts should be barred from any legal commerce in controlled wildlife species. The U.S. proposal was on the agenda of the Oct. 2-6 Geneva meeting of the Convention on International Trade in Endangered Species.

But some free-market environmentalists advocate a radically different strategy: allowing people to raise the animals on farms, slaughtering some and selling their parts legally. The idea is endorsed by the nonprofit **Property & Environment Research Center** in Bozeman, Mont. "It's the species we want to save, not the individual animal, harsh as that may sound," says executive director Terry Anderson.

An article in the September issue of the group's magazine argues that such farms

would lower prices for tiger parts and lessen the profit motive for poaching wild tigers. The article's author, Barun Mitra, director of the **Liberty Institute**, a research group in New Delhi, says that tiger farming in India and China could also produce tigers for release into the wild.

The strategy is fiercely opposed by some other groups, including the **World Wildlife Fund**. "No countries have regulatory systems in place that could effectively control a legal trade in tiger parts," says

Crawford Allan, who monitors tiger trafficking. Poachers, he says, could use a legal market to launder parts harvested from wild tigers.

—Peter Coy



## SUNDAY DRIVING

**CALL IT** gearing up with gospel. The Chrysler Group is trying to get more African American customers by targeting churchgoers. The idea grew out of Chrysler's sponsorship of a gospel concert tour starring Patti LaBelle at megachurches in 12 cities. A few days before each concert (the first is Oct. 7 in Dallas), Chrysler will be at the church, giving free tickets to those who show up to test-drive some of its 2007 vehicles. Spokesman James Kenyon said the taste issues of marketing through churches didn't come up at Chrysler. And who knows? Perhaps the campaign will revisit the question Evangelical Environmental Network asked in 2002: "What Would Jesus Drive?" Umm, a Chrysler minivan? "Plenty of room for the loaves and fishes," jokes Kenyon.

—David K

## THE CARTOON



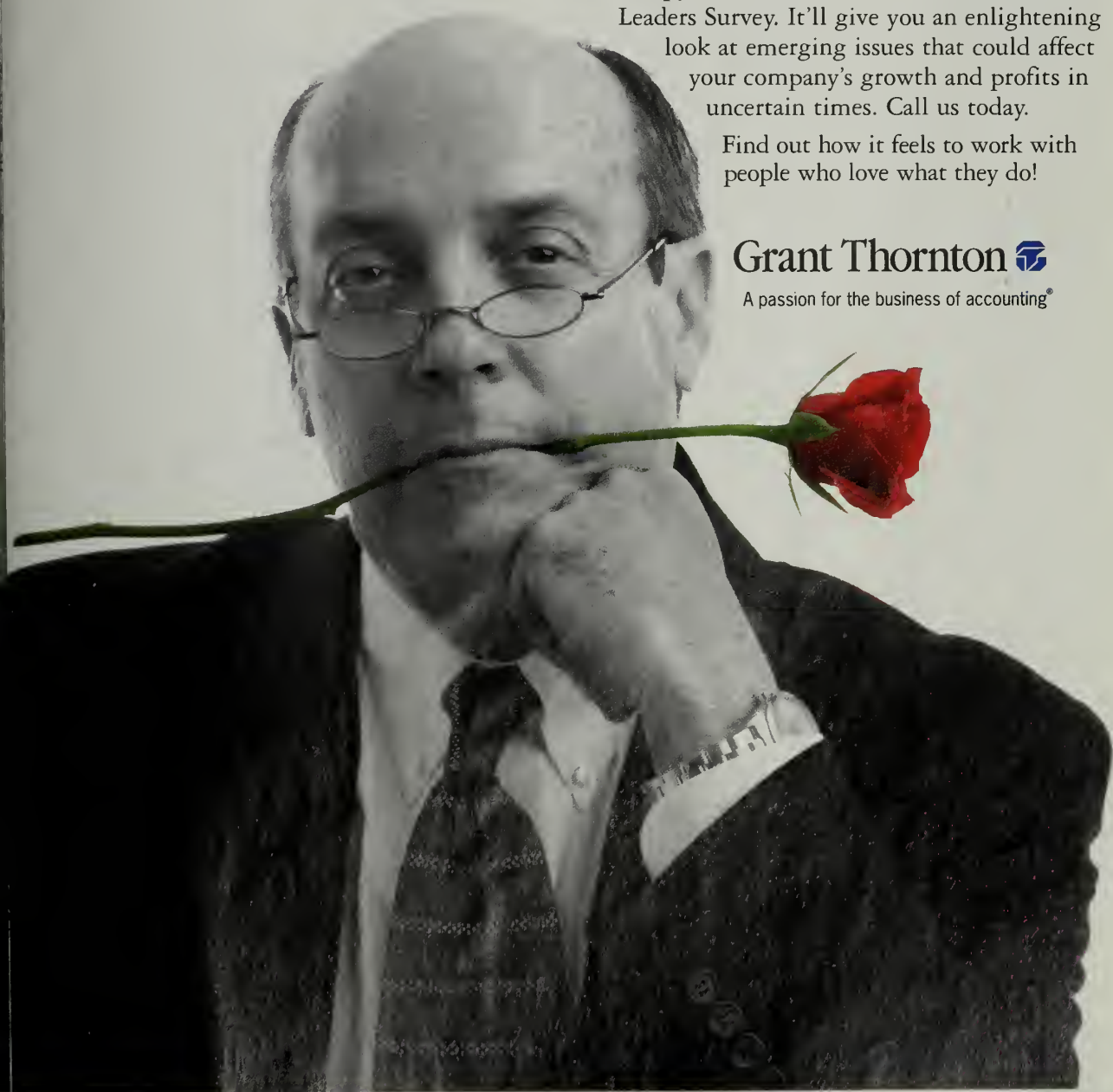
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## CEO PAY



## I'LL HAVE WHAT HE'S HAVING

Behind every overpaid CEO, there's likely to be a collection of overpaid CFOs, COOs, and other top managers. So says a study by a trio of professors from **Stanford, Rutgers, and Penn State**. "The argument out there has been: 'Maybe a CEO is paid \$10 million or \$20 million—that's a drop in the bucket at most companies.' But if it's being multiplied out over many levels, it's more serious," says **Tim Pollock**, a co-author and an associate management professor at Penn State.

To define "overpaid," researchers compared CEO pay at 120 corporations, looking at averages for companies in similar industries with like revenues and returns on assets. Differences in CEO tenure were also factored in. At the company with the most bloated pay, the CEO was overpaid by 64%, and those reporting directly to him by 26%. Middle managers got only a 12% boost. And here's an unsurprising finding: If a CEO was also chairman of the board, he and his staff were more likely to be overpaid.

—Nanette Byrnes

## THE MESSAGE

## WHEN GECKOS AREN'T ENOUGH

**THE INSPIRATION** for Geico's latest ad campaign, a droll take on customer testimonials, was Warren Buffett, says Ted Ward, the company's vice-president for marketing. Buffett, whose Berkshire Hathaway owns the car insurer, wanted to use some of the laudatory letters Geico gets from customers who have filed claims.

"Then we asked: 'How do we Geico-ize the testimonial concept?'" says Steve Bassett, the account's creative director at the Martin Agency, Geico's ad shop since 1994. The answer: to wink at it, using celebrities like Little Richard, Burt Bacharach, and Charo to "help" those real-life customers tell their tales in front of the camera.

The real Geico twist here, though, is that the celebrity ads are running on radio and TV at the same time as the insurer's other quirky campaigns—the sensitive caveman ads and the commercials dominated by the Cockney-accented gecko. Overlapping ads are not the norm. But "Geico doesn't stick to one image," says Siva



Vaidhyathan, an associate professor of culture and communication at **New York University**. "It's trying to keep people off-balance, trying to start a variety of conversations."

Geico's Ward says the scattershot strategy is new to lure customers in all demographic groups away from rivals. While competitors like **Allstate** use agents to sell their policies, Geico doesn't use middlemen. It relies entirely on its advertising, which directs people to the

company Web site. "The spokesperson

gecko or caveman is a decent substitute for an agent," Ward says. Besides, he notes, while the campaigns may differ, the insurer's 13-year-old tag line stays the same ("15 minutes could save you 15% or more..."). The company won't reveal its ad budget, but Ward says that Buffett's urging Geico is "absolutely spending more on advertising now to increase market share." Vaidhyathan of NYU says it's money well spent "if you are quoting your ads in high school hallways." The buzz has reached NBC's *Saturday Night Live*, which recently spoofed the already tongue-in-cheek "real person" campaign. —Aili McCon



» **THE BRAND** Geico » **THE CAMPAIGNS** A gecko, assorted celebrities, and the caveman run simultaneously » **THE VERDICT** Overlap can make for good buzz

## REALTY CHECK

## THE HALLOWED HALLS OF GOOGLE



**IT TOOK** 62 years for **Hewlett-Packard** to buy the Sili Valley garage of its founders. By contrast, just eight years after **Google's** founding, the company has bought the ranch-style house in Menlo Park, Calif., where Sergey Brin and Larry Page first ran things in 1998, using three of four bedrooms and the garage. The search giant won't reveal the price, but real estate site Zillow.com estimates the value of the 42-year-old house at \$1.2 million. Google says it has no firm plan for the house beyond preserving it. —Robert D.

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## SPACE SHOT

### NASA'S 'FIRST DATE' WITH CHINA

**IN ITS SPACE** programs, the U.S. has had no shortage of partners, teaming up with more than a dozen countries. A notable exception: China, the third nation (after Russia and the U.S.) to launch a human into orbit. Guided by U.S. laws that forbid the

transfer of advanced technology to a communist state, NASA officials have always rebuffed the idea of any tie-up with China's military-run space program.

Yet there are signs of warming. On Sept. 28 five top NASA officials returned from a five-day tour of China's space operations. The U.S. team visited research labs in Beijing and explored test facilities in Shanghai. The group declined an invitation to check out the Jiuquan Satellite Launch Center in the Gobi Desert, the center of China's manned space efforts, because they were barred from seeing



anything but launch pads.

Awkward moments aside, the NASA team focused on the upside—"a first date," NASA Administrator Michael Griffin called it. The two sides discussed plans to share data on future unmanned earth and lunar orbiters along with the possibility of placing a U.S. sensor on a future Chinese moon mission. Discussions about manned missions remain off limits.

Could China help the U.S. space effort? A manned moon mission was proposed by President George W. Bush last year, with the cost predicted to exceed \$100 billion. But because of limited budgets, "the systems specific to going to the moon cannot be developed until after the shuttles are retired in 2010," says John Logsdon, director of the Space Policy Institute at

George Washington University. The estimated \$500 billion-plus cost of a manned mission to Mars, called for by both Bush Presidents, would strain budgets even more.

A space program that includes China, along with today's partners in the International Space Station, could have payoffs for both countries. Beijing would like to crib from NASA's notes on the complex challenges of manned space flight. Washington would benefit from access to Beijing's deep pockets.

Meanwhile, China is already making some great leaps on its own. Its third manned Earth orbiter is slated for next year, and it is on track to send an observation satellite to the moon by 2008, followed by a robot rover in 2012. A manned moon shot would come next. —Adam Astor

## QUESTION OF THE WEEK

The networks have gotten some good press about their fall lineup—NBC's *30 Rock* and *Studio 60* (two shows about network TV), CBS's *Jericho*, and ABC's *Ugly Betty*, for instance. Is a strong lineup enough to lure viewers back from cable and other media options? —Jon Fina

"Yes. They were trying for so long to do everything on the cheap. They realized they had to spend money. Network TV proves if you throw money at a problem, it works. You get better writers, actors, and ratings."

Nikki Finke,  
L.A. Weekly columnist and  
deadlinehollywooddaily.com blogger



"The superior content will be leveraged across multiple platforms. That's the right strategy for major media companies. But consumer viewing patterns are shifting rapidly. The question is, can the business models catch up fast enough?"

Aryeh Bourkoff,  
managing director/media analyst, UBS



"While quality doesn't necessarily translate into quantity, it often translates into more desirable audiences. Still, it doesn't change the underlying issues that threaten network TV's dominance in the media mix."

Scott Donaton,  
associate publisher, Advertising Age



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Rosie the Riveter is a perfect representative... of the roll-up-your-sleeves attitude of working until the job is done.

—Janet M. Gourley  
 La Verne, Calif.



### THE HEALTH-CARE ECONOMY: BRICKBATS AND KUDOS

THE REALITY of broad-based job growth in recent years is at odds with your Sept. 25 Cover Story, "What's really propping up the economy." The writers mistakenly concluded that the health-care industry is the only part of the private sector that has added jobs since 2001.

Health care is a vital, job-generating sector of our economy but is not, as the article asserted, the only one. Since January, 2001 (the article's baseline year), employment has grown across most major industries, including: financial activities (+578,000 jobs), professional and business services (+555,000), construction (+697,000), leisure and hospitality (+1.1 million), and public and private education (+1.2 million).

The Bureau of Labor Statistics projects that the health-care industry will account for about 20% of employment growth in 2004-14. That means 80% will be in other industries.

There are excellent career opportunities for American workers in a broad range of industries, including health care. For a full and accurate picture of job growth and the labor market, I urge

readers to look at the Labor Dept.'s August, 2006, report, "America's Dynamic Workforce," which can be found at [www.dol.gov](http://www.dol.gov).

—Ronald Bird  
 Chief Economist  
 Labor Dept.  
 Washington

*Editor's Note: Ronald Bird cites several areas where private jobs have grown since 2001. But most of those gains are the direct or indirect result of the health-care—and housing—booms. Within the financial sector, for example, health insurance, real estate, and mortgage-related jobs account for almost all the growth since 2001. By contrast, the securities industry and insurance (outside of health insurance) have lost jobs over the same stretch. Similarly, many of the job gains in professional and business services were in real estate-related industries, including architectural and engineering services and services to buildings and dwellings. Finally, roughly two-thirds of the added education jobs mentioned by Bird were in the public sector.*

—Michael Mandel

YOUR ARTICLE asserts that if there were no growth in health-care jobs, then

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# ReadersReport

there would have been no growth in jobs at all in the U.S. Any employer will tell you this assertion fundamentally confuses cause and effect: Increased health-care costs have curtailed hiring.

A more logical conclusion: If the U.S. had not spent so much more on health care in the past five years, then more jobs would have been created in other industries with the freed-up cash.

—Steven Willson  
Crystal Lake, Ill.

THIRTY YEARS AGO, economists predicted an inexorable change to a service economy in the U.S. Is it not happening? Mandel contends the industry is too labor-intensive, with insufficient investment in technology. Perhaps so, but that may change. The U.S. economy is not static. There were people decrying the collapse of the buggy-whip industry years ago.

—Thomas Brent  
Foresthill, Calif.

THE ROBUST job growth in the health-care sector actually began 15 years ago with the demise of the Cold War. Thousands of engineers and workers retooled themselves from arms and armament

manufacture to health-care insurance and technology.

Correcting the much-vaunted underinvestment in information services, however, will be unlikely to diminish the need for thousands of physicians, nurses, and technicians. We care for our patients with repeated encounters and exquisite attention to detail. Information technology may speed the flow of health-care data, but it is less likely to reduce the cost.

—Frank Welsh, M.D.  
Cincinnati

NICE ART on the Sept. 25 cover. As a nurse practitioner, I can appreciate everything that makes Rosie the Riveter a perfect representative of not only the idea that the health-care professions are propping up the economy but also the “roll-up-your-sleeves” attitude of working until the job is done. Rosie “the nurse” is more than tough: She is resolute. Art like this can be one way of inspiring interest in a profession that is experiencing critical shortages at this time.

—Janet M. Gourley  
La Verne, Calif.

I APPRECIATE and agree with much of the analysis in Mandel’s article. His statement that information technology employment has declined in current expansion is misleading. V industry-based IT employment has declined as Mandel accurately notes, IT occupations (in both IT and non-IT industries) have in fact added more than 200,000 jobs since 2001, according to data from the Bureau of Labor Statistics. Far from being a “disappointment,” information technology has created many new paying jobs throughout the economy and revolutionized the way America does business.

—Jeremy Leo  
Chief Economist  
American Sentinel University  
Monroeville, Pa.

YOUR COVER STORY on health-care jobs paints a bullish picture about the industry’s growth. However, it ignores the flip side of the coin: How and where do we find people to fill the “30% to 40% of all new jobs created over the next 10 years”? It won’t be easy, given the departure of baby boomers from the workforce and the growing need for persons

## DREAMREWARDS TRACKER: CHECK YOUR PROGRESS TO PARADISE



# YOU'VE EARNED MORE



workers to assist the elderly and with disabilities.

Currently, there is a bill in Congress that provides states an option to help increase the wages for direct-support personnel in the private sector through increased Medicaid funding for a five-year period. As the wages for these workers are almost exclusively funded through Medicaid, this is a reasonable compromise between limiting the expansion of Medicaid and helping ensure a stable, qualified workforce both now and for the future.

Here's another idea: Let's utilize the abilities of people with disabilities so they, too, can meet a personnel need that will be challenging health care workers well into the future.

—Thomas H. Fanning  
President & CEO  
Ability Beyond Disability  
Bethel, Conn.

## CONSTRUCTING ACTIVITY

BASED ON your innovation supplement, in "The truth about brainstorming" (Inside Innovation, Sept. 25), two key points were absent: Brainstorm-

ing is conducted in all stages of the creative process. You brainstorm about the goal you want to accomplish. You brainstorm about the facts associated with the situation you want to change and who is the decision-maker. You brainstorm to discover what the real problem is and why that is so. Next, you brainstorm for ideas and possible solutions; then how you might evaluate possible ideas/solutions; and finally, you brainstorm ways to gain acceptance and implementation of the best idea or combination of ideas. The last stage should take up 80% of your time and resources as compared with the previous brainstorming stages.

—Frank L. Maraviglia  
President, Creativity Unlimited  
Syracuse, N.Y.

## A FINE WINE, WITH A HINT OF SKEPTICISM

ROBERT PARKER'S "Jack of two grapes, master of both" (Executive Life, Sept. 4), described the flavors he found in the list-



## INSIDE INNOVATION, SEPT. 25

ed wines: flowers, raisins, plums, figs, incense, Asian spices, cedar, spice box, dried herbs, oak, crème de cassis, licorice, graphite, black olives, black carrots, blackberries, smoke barbecue spice, tapenade, acacia, roasted meat, *pain grillé*. Is he serious or joking?

—Howard Purcell  
Amagansett, N.Y.

## INCENTIVES HELP SPREAD THE REMANUFACTURING BUG

"EVERYTHING old is new again" (The Corporation, Sept. 25) is a great example of how we can make our resources unlimited. These companies have found ways to reuse old resources rather than turning them into waste.

I like how Caterpillar Inc. developed incentives for its customers by selling them cheaper replacement parts if they return their used ones. Our government



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# ReadersReport

is going to have to build incentives like this some day. Thank you for sharing this example. Hopefully, others can catch the "remanufacture" bug.

—Sam Patton  
Erie, Colo.

## IS YOUR MANAGEMENT CONSULTANT CERTIFIED?

THE CLIENT EXECUTIVE is responsible for identifying whether a consultant is needed, selecting the right one, and managing the scope of services ("A twisted chain of command," The Welch Way, Sept. 18). A consultant may play a part in these decisions, but this does not justify implying that all consultants are selfish and unprofessional. Furthermore, finding a qualified consultant does not have to be hard.

Because the management consulting profession is unlicensed, clients must have a reliable means to identify professional consultants who are committed to technical competence and high standards of ethical conduct. The Certified Management Consultant (CMC) designation represents the standard of competence and ethics that is accepted in 44 countries, including the U.S. The CMC designation is awarded to consultants

In "Sonsini under scrutiny" (News & Insights, Oct. 2), a caption pointing to a photo of former Hewlett-Packard Co. CEO Lew Platt incorrectly implied that Platt, rather than lawyer Larry Sonsini, "was under fire for his role" in the current leak scandal at HP. Platt, who died in 2005, left HP years before the spying scandal began.

"Click fraud" (Cover Story, Oct. 2) incorrectly reported that Expedia.com is owned by IAC/InterActiveCorp. In fact, it is owned by Expedia Inc., which was spun off from IAC/InterActiveCorp in 2005.

"The emblems of war" (Executive Life,

## CORRECTIONS & CLARIFICATIONS

Oct. 2), incorrectly stated that "collectible guns (and the armaments on tanks and warplanes) must be disarmed according to strict federal standards." In fact, it is legal to own many working collectible guns, although large-caliber and fully automatic weapons are strictly regulated by federal and state laws. Working guns of all kinds are also subject to state and local laws that in some locales restrict their purchase and ownership.

In "The talent hunt" (Special Report, Oct. 9) Massachusetts Institute of Technology's B-school was listed as Sloan School of Business in Boston. It should be MIT Sloan School of Management in Cambridge, Mass.

who demonstrate client satisfaction and consulting competence, and who pass a rigorous peer review panel as well as both written and oral ethics examinations.

—Mark R. Haas, CMC  
National Board Chair  
Institute of Management  
Consultants USA  
Washington

## CONSUMERS WOULD PAY MORE FOR 'MADE IN USA'

THE DATA DETAILING the U.S. trade gap with China—specifically, the numbers related to all things electronic such as televisions, phones, audio equipment, and computers—is less consumer-driven and more original-equipment manufacturer (OEM)-driven. ("Why the gap won't stop growing")

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al Business, Sept. 25). For most  
ucts of these types, we consumers  
few choices but "Made in China"  
n making a purchasing decision. As  
plus-year veteran of the electronics  
stry, I see more manufacturing  
ing to China every year. While the  
fits of lower prices benefit con-  
ers at the cash register, there are  
y of us out here who would be will-  
to pay 10% to 15% more for an  
valent product made in the U.S.  
y, we do not have a choice in our  
hasing decisions.

—Bret Daniels  
Director of Sales  
Fairchild Semiconductor  
San Clemente, Calif.

## TAXMAN COMETH NOT FROM THE IRS

THE EYES of taxes are upon  
(Government, Sept. 25), the issue at  
l is not whether the tax collection  
ourcers are more expensive. It is  
her they are more effective. As long  
e tax collection outsourcers can  
rate more net federal revenue than  
Internal Revenue Service's own  
force, then the IRS should continue

to use third parties for collecting Amer-  
icans' taxes.

—Tim Bohdan  
Katy, Tex.

## THERE'S ALWAYS UNCERTAINTY IN THE PATENT GAME

"WHY PETER Dolan got the boot" (Sci-  
ence & Technology, Sept. 25) on his  
ouster at Bristol-Myers Squibb was un-  
duly harsh on Dolan. As a patent lawyer  
practicing in the pharmaceutical field, I  
want to make readers aware that almost  
half of all patent trials are modified on  
appeal (i.e., either reversed outright or  
modified and returned to the trial court  
for further proceedings). Thus, the ques-  
tion still remains unanswered whether  
Dolan's misgivings regarding the  
strength of patents on Plavix were un-  
warranted. An appeal by the ultimately  
losing party is a virtual certainty.

In any event, the systemic problem re-  
mains: Patent cases are tried in courts of  
general jurisdiction having little scientific  
or patent law expertise (federal district  
courts), but are appealed to a court of  
highly specialized jurisdiction (the Court  
of Appeals for the Federal Circuit, which

handles all patent appeals). Hence the  
uncertainty in the patent litigation game.

—Joseph T. Leone  
DeWitt Ross & Stevens  
Madison, Wis.

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# Gutenberg 1, Sony 0

In an age when digital distribution of content is becoming the norm, the oldest mass medium has remained stubbornly resistant. Most recorded music is available for download, as are newspapers, magazines, and some TV shows. But books remain stuck in the Gutenberg era, with minuscule sales of the few titles that exist in electronic form.

Sony's much delayed Reader aims to change that. It will be available in October for about \$350, which includes a credit for \$50 in book purchases. Even though the Reader has its flaws, it's a vast improvement over various other e-book designs rolled out in the past decade. I can't say the same for the clunky software that manages book purchases and Reader downloads on a Windows PC, or for Sony's attempt at an online bookstore, which is reminiscent of its clueless efforts to sell music online.

The 12-oz. Reader is about the size of a standard paperback. Just half an inch thick in its handsome black leather cover, it has enough memory to store dozens of books. When the Reader is set to a standard type size, the 4¾-by-3¾-in. screen contains perhaps half as much text as a typical book page. The display itself is revolutionary. E Ink, a Massachusetts Institute of Technology spin-off, has been laboring for years to perfect the technology, which generates crisp black letters by selectively rotating millions of half-white, half-black balls.

While far better than the monochrome displays on earlier e-books in both appearance and power consumption (it will run for days on a charge), the Reader falls short of real print on paper. The promised black-on-white effect is more like dark gray on light gray. And when you press a button to turn a page, it takes about a second to respond, during which interval the page turns black, a minor but distinct annoyance.

**ANY E-BOOK READER IS BOUND TO INVOLVE** compromises. The Sony Reader's storage capacity is effectively unlimited, since you can add memory cards. This lets you carry a library of books in a tiny package. On the other hand, the reading experience is far inferior to that of a real book, partly because all concept of page design is lost. For example, in the best-selling *Freakonomics*, tables that are barely legible on the Reader to begin with sometimes break over two pages. Files downloaded from a computer (via a USB cable) fare worse. I found that most PDF files were unreadable even in the largest type size, and I could not get Word files to download at all.



## Its Reader is hurt by clunky software and a clueless bookstore

Another big limitation is that the display can show only four shades of gray, thus restricting graphics to line drawings. This essentially disqualifies the Reader from on its most attractive uses, textbooks.

These deficits, however, pale compared to Sony's Connect bookstore (ebooks.connect.com), which seems to be the work of someone who has never visited Amazon.com. Sony offers 10,000 titles, but that doesn't mean you will find what you want. For example, only four of the top 10 titles on the Oct. 1 *New York Times* paperback best-seller list showed up. On the other hand, many books are priced below their print equivalents—most \$7.99 paperbacks go for \$6.39—and can be shared among any combination of three Readers or PCs, much as Apple iTunes allows multiple devices to share songs.

The worst problem is that searching the essence of an online bookstore is broken. An author search for "Brown" turned up 84 books, three of them by Dan Brown, the rest by people named Dan or Brown or sometimes neither. Putting a search term in quotes should limit the results to those where the exact phrase occurs, but at the Sony store, it produced chaos. "I Brown" yielded 500 titles, mostly by people named neither Dan nor Brown. And the store doesn't provide suggestions for related titles, reviews, previews—all those little extras that make Amazon great.

The problems of the store and software are fixable. But unless Sony repairs them fast, the Reader may be headed for the scrap heap of failed e-book readers. ■

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## On TV, It's Politics as Usual

**Tonight, TV viewers who live in political battleground states**—Montana, maybe, or Ohio—will spend commercial breaks, white knuckles on the remote, desperately fleeing the blitz of political ads. Some may get sufficiently disgusted to turn off the TV and head over to their computers. While online, they may well be bombarded by pop-ups and ads, but few

will hawk a candidate or cause.

Political advertising remains strenuously, and almost uniquely, devoted to broadcast TV. Despite other advertisers' mania for anything Net-related, as this election cycle enters its closing weeks, astonished station owners report political ad revenues are smashing expectations. This signifies either an incredibly backward attitude toward the selling of American politicians or proof positive that there are things the media superhero known as the Internet still can't do. Will Feltus, senior vice-president for media research at National Media, which bought George W. Bush's ads in 2004, cites Howard Dean's Presidential campaign to say that while the Web "can ignite the engines," an Internet-heavy political ad campaign "is not going to get you to escape velocity by itself." But it is still disorienting to hear, in late 2006, some of the nation's smartest political operatives making pre-TiVo—if not pre-remote control—arguments for the primacy of TV.

**CANDIDATES ARE PERVERSE PRODUCTS.** They are sold through ads notable for their unrelenting awfulness. A candidate's sole marketing aim is to win a plurality of market share on one specific day. This stamps a very strict sell-by date on the goods, and there is no upside in coming in under budget. In many non-Presidential races, you're selling a product that's unknown to wide swaths of the marketplace until shortly before Election Day, and insufficient time and money often precludes a months-long product rollout. Given the audiences broadcast still commands, "if you need to get to 51% in a short period of time, TV still makes a hell of a lot of sense," says Carter Eskew, the chief strategist for Al Gore's 2000 Presidential run. So campaigns still buy in bulk. "We had planned for the same amount of [political] dollars as 2004," says John Hendricks, vice-president for sales at Tribune Broadcasting's 25 mostly Fox and CW stations. Tribune blew past that figure in early September. Now Hendricks says they'll beat 2004's \$25 million take by 40%. As of September 24, according to media tracker



### As other ad dollars flow to the Web, campaigns keep betting on TV

or Yahoo! News' front pages. Feltus says annoying consumer with pop-up ads may leave a potential voter disinclined to support a candidate. True, but exactly how much TV ads annoy voters, and how many of those ads are routinely skipped, are points of secondary concern to Democratic and Republican Svengalis. The first candidate to use the Web to win votes—not just raise money, or rally the faithful—will come from outside mainstream political circles. As with everything else in politics, change won't come from where the consultants roost. ■

TNS Media Intelligence, all political spending on broadcast TV was \$710 million, which nearly triples 2004's national Presidential TV spending. Web spending through July, the most recent figures available: \$1.7 million.

To borrow a failed Al Gore catchphrase, powerful forces stand in the way of political dollars moving to the Web. One is the irredeemable squareness of American politics, which in many ways still seems stuck around 1950. Two-party politics tend to be risk-averse, especially when the margins are so close in key states. It's a truism that campaign

are better off focusing on sure thing voters than expanding the electorate with the youth vote. Older voters are likelier to head the polling station, and more likely to congregate around Fox News than Facebook. Politicos also suspect most Web surfers seeking political information are not persuaded and visitors to blogs like Daily or Little Green Footballs know damn well how they'll vote.

Which doesn't explain why political ads don't clutter CNN,

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JAMES C. COOPER

# Stock Investors Seem to Hold the Winning Hand

...to suggest a soft landing, not the recession the bond bulls fear

**U.S. ECONOMY** O.K., investors, place your bets. Will it be stocks or bonds? Maybe both? During the past three months, both stock and bond prices have staged powerful rallies from their June lows. Through Oct. 4, the Standard & Poor's 500-stock index has soared more than 9%, and since bond yields move in the opposite direction

...ces, the yield on the benchmark 10-year Treasury has dropped from 5.24% to 4.55%. These twin rallies have been fueled by one overriding factor: investors' belief that slower growth and cooler inflation will allow the Federal Reserve at least to hold steady in coming months or even to begin cutting next year. The futures markets give high chances of a quarter-point cuts in the next year and a half. But this is where the agreement between stock and bond investors ends. After all, if the economy is weak enough to provoke the Fed into slashing rates, then it also will be too weak to generate the profit growth that would justify the recent runup in stock prices. Bond investors appear to be embracing the risk that the housing slump could turn into a broader downturn, while stock investors are optimistic that the economy will keep growing at a moderate not-too-hot, not-too-cold pace. Stock and bond investors can't both be right. Bottom line: The economy's performance in the next few quarters will decide who wins and who loses.

**LOOKED ON A CLOSE LOOK** at recent economic data and the key underlying trends, stock investors seem likely to be in the most chips in the coming year. That's because the odds still favor a soft landing for the economy as growth slows, not the hard crash that many bond bulls appear to be betting on. The latest numbers on consumer spending, capital spending, business construction, and industrial production continue to show the economy outside of housing holding up well. The runup in stock prices, including a record close for the Dow Jones industrial average on Oct. 3, and the drop in long-term interest rates, which has translated fully into lower mortgage rates and easier corporate borrowing, will add support. So, while the housing slump is far from over, several indicators show the necessary adjustments are well advanced. In August sales of existing single-family homes declined, and pending home sales actually rose, as did sales of newly built homes. Sharply lower mortgage rates and home prices are helping affordability, and the uptick in housing starts means builders have already begun a big step toward cutting bloated inventories.

The positive effects of the sharp drop in energy prices have yet to show up in reports on consumer prices, household spending, or factory production. That will be a key factor bolstering fourth-quarter growth. Higher energy costs dampened business and consumer confidence earlier this year, but consumer sentiment began to rebound in September. Future measures of

business optimism undoubtedly will show the same pattern.

Unlike in the bond market, stock investors aren't buying the notion that the housing slump will drag down consumer spending. During September the "consumer discretionary" category of the S&P 500, comprising department stores and

## STOCK MARKET GAINERS IN SEPTEMBER

| S&P 500 SECTOR*        | GAIN<br>AUG. 31-SEP. 29 |
|------------------------|-------------------------|
| CONSUMER DISCRETIONARY | 6.4%                    |
| FINANCIALS             | 4.1%                    |
| INFORMATION TECHNOLOGY | 4.0%                    |
| TELECOMMUNICATIONS     | 4.0%                    |
| INDUSTRIALS            | 3.8%                    |
| HEALTH CARE            | 1.4%                    |

\*MATERIALS, CONSUMER STAPLES, UTILITIES, AND ENERGY POSTED DECLINES  
Data: Bloomberg Financial Markets

other retail concerns, posted a 6.4% advance, the strongest of any major sector (table).

Indeed the growth rate of consumer spending appears to be accelerating. After advancing at an annual rate of 2.6% in the second quarter, real consumer outlays through August suggest a third-quarter pace of about 3%. The added buying power from falling gas prices could result in an even faster growth rate in the fourth quarter.

**THE OUTLOOK FOR CAPITAL SPENDING** is also strong, partly because the corporate sector is in pristine financial condition. Second-quarter profits and cash flow were at record levels, and profit margins of nonfinancial companies still were above the peak levels hit in the late 1990s. In the first half of the year, the corporate sector had enough internally generated funds to pay for all of its capital expenditures. At the same time, companies were buying back stock at a blistering annual rate of about \$550 billion, more than double the pace two years before.

Recent reports show businesses are also devoting plenty of cash toward expansion. Through August, orders for capital goods outside of commercial aircraft are



growing faster in the third quarter than they did in the second. Unfilled orders are also growing rapidly, indicating demand is running well ahead of production.

Plus, while residential construction is wilting, new business structures are sprouting fast. In August private-sector spending on residential housing fell 1.5% from July, but outlays for business projects jumped 3.4%, with especially large increases in manufacturing and commercial buildings. So far this year, residential spending is down \$49 billion, but nonresidential outlays, up \$37 billion, have offset much of those losses.

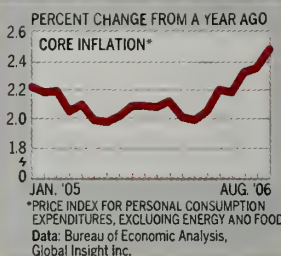
**REPORTS OF WEAKNESS** in the third quarter that have generated fears of a broad economic slump stem from three main sources: the housing downturn, the lagging effects of the summer surge in oil prices, and cutbacks by automakers. The dip in industrial activity reflects all three. Some sectors, especially autos, are trimming inventories, but those output adjustments will be neither broad nor long-lasting.

For example, the September purchasing managers index—a composite of orders, production, employment, delivery speeds, and inventories in the industrial sector—declined, but the largest drops were in inventories and jobs. Output rose, albeit more slowly than in August, and orders continued to increase at the August rate. As long as consumer and business demand keeps growing solidly, the industrial sector will fare better in coming months.

The growth debate between stock and bond investors highlights another key issue in the two markets: the near-

term direction of inflation. Given the drop in energy prices, overall inflation is sure to decline substantially. But stock investors appear to recognize lower energy prices as a plus for both inflation and economic growth while many bond bulls seem to be ignoring cheaper oil growth benefits.

## WHERE INFLATION REMAINS STUBBORN



The plunge in bond yields implies bond investors think a weak economy will also bring down core inflation, which excludes energy and food. However, despite slower growth the second and third quarters, core inflation continues to accelerate. In August the Fed's preferred price gauge sped up to a 2.5% rate

from the past year, the highest reading in 11 years (chart). If core inflation stays stubborn, the Fed might wait patiently for it to ease but won't be willing to cut rates way bond investors now anticipate.

In 2007 the combined performance of stocks and bonds in your portfolio will depend more than usual on how the economy shapes up. Of course, the best investors aren't always the best economic forecasters, but for next year the choices are clear: A weak economy favors bonds. Continued moderate growth will help stocks. ■

## HOME BUYING

# More Scrutiny for High-Risk Mortgages

**THE HOUSING** market may have received another blow. New guidance put out by U.S. bank regulators warned lenders to keep up their due diligence when issuing exotic mortgages. The impact could be fewer mortgages and less demand for homes.

Five agencies, including the Federal Reserve and the Federal Deposit Insurance Corp., issued guidelines on Sept. 29, effective immediately, on how banks should handle nontraditional mortgages. These comprise loans that have low introductory interest rates or offer initial interest-only payments. Another nontraditional category is adjustable-rate mortgages with payment options.

The move by regulators was caused in part by recent trends in exotic mortgage lending, including more option ARM borrowers opting for an initial minimum payment that may not cover interest costs. As a result, the agencies are requiring that banks thoroughly assess a borrower's capability to pay off a loan especially after the introductory period of lower payments ends.

The guidelines could exacerbate the slowdown in the housing market. "A meaningful number of people who could borrow on very loose terms won't be able to do so in the coming months," says Andy Laperriere, managing director at International Strategy & Investment, an

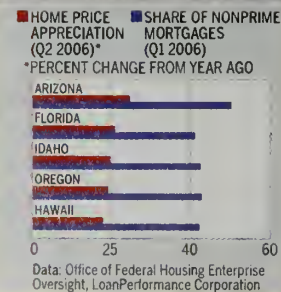
investment advisory company. During the first half of 2006 approximately 30% of all mortgages originated were nontraditional, according to the newsletter *Inside Mortgage Finance*.

What's more, the hottest housing markets are likely to feel the biggest impact. In states where prices have surged in recent years, a greater share of home buyers has opted for nontraditional mortgages. High prices and rising interest rates have made homes less affordable, leaving these mortgages as the only option for some borrowers.

A decline in the number of potential home buyers will add downward pressure on home prices, says Laperriere. While the guidelines are intended to protect lenders and consumers, the timing is inauspicious for a housing market already in the throes of a downturn. ■

—By James Mehring in New York

## HOT HOME PRICES SPARK EXOTIC MORTGAGES



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# The Business Week

## News you need to know

EDITED BY HARRY MAURER



**The Dow Does It** Like a groundhog gingerly poking its nose above ground, the stock market finally pushed past its previous peak. Having set a new mark on Oct. 3, the Dow on Oct. 4 stood at 11,850.6, about 1% above its high on Jan. 14, 2000 (a Times Square display, photo). The big winners? Two old-economy companies: **Altria**, up 220% since the 2000 peak, and **Caterpillar**, with about a 150% gain.

Still, while the Dow, with only 30 stocks, stands at record heights, broader-based indexes don't look so spiffy. The **S&P 500** languishes 12% below its 2000 high, while the **Russell 3000** remains 8% under. One more cautionary note: Adjusting for inflation, the value of the Dow today is 12% lower than it was in January, 2000. Will that groundhog come all the way out into the sun?

See "Stock investors seem to hold the winning hand," page 33

**HP: Indictment Time** On Oct. 4, California Attorney General Bill Lockyer filed four felony charges each against ex-Hewlett-Packard Chairwoman Patricia Dunn, ethics officer Kevin Hunsaker, and four others involved in the corporate snooping scandal.

**Airbus' Late Arrival** This plane just doesn't want to take off. On Oct. 3, Airbus CEO Christian Streiff disclosed that the doubledecker A380 isn't some months behind schedule but a full two years. That'll slice \$6.1 billion off profits over the next four years. Production has stalled because some factories used incompatible design software, so the electrical wiring doesn't fit into the fuselage. Streiff

plans billions in cost savings to offset the financial hit. Airbus' woes could deepen if the A380's biggest customer, Emirates, cancels some of its 45-plane order.

**ONLINE** See "Airbus: Stalled on the runway" [www.businessweek.com/go](http://www.businessweek.com/go)

**Know When to Hold 'Em...** Apollo Management Texas Pacific Group shoved lots of chips into the pot, bidding \$15.1 billion for gambling giant Harrah's Entertainment company said on Oct. 2. But the paydays may be over another sector of the biz: Internet gambling. The House and Senate passed a bill on Sept. 30 that prohibits businesses from accepting payments for betting. It requires the Treasury Dept. and the Fed to force banks to block transactions. Online gaming stocks sank.

See "Private equity: A bid too far," page 42.  
**ONLINE** "Harrah's: Long odds on the LBO" and "Online gambling still in the cards?" [www.businessweek.com/go](http://www.businessweek.com/go)

**GM: No Deal** Forget about the grand alliance between GM and Renault-Nissan that Kirk Kerkorian proposed months ago. GM's board decided on Oct. 3 that the good from an alliance would flow mostly to Renault. To that end, GM wanted \$2 billion to \$3 billion, says a source close to Renault. GM also wanted to be free to enter joint ventures with other carmakers. Renault CEO Carlos Ghosn said no thanks. So Kerkorian, who's talking about increasing his 9.9% stake to 12%, will have to find another way to get GM's stock or wait for CEO Richard Wagoner's fix-it job. Ghosn may soon be talking to Ford.

**ONLINE** See "What will Kirk do now?" [www.businessweek.com/go](http://www.businessweek.com/go)

**The EU vs. Intel?** U.S. tech outfits may not have reason to fear these days from domestic trustbusters, but Europe is another matter. Not long after a federal court in Delaware on Sept. 26 threw out big chunks of Advanced Micro Devices' antitrust suit against Intel, the EU seemed to be gearing up for action against the No. 1 chipmaker following an inquiry into whether it used a mix of incentives and threats to keep retailers from selling AMD-equipped computers. The EU already is trying to fine Microsoft nearly \$1 billion for allegedly squashing competition. An Intel spokesman says its practices are fair and legal.

**ONLINE** See "EU ready to pounce on Intel" [www.businessweek.com/go](http://www.businessweek.com/go)

**A More Muscular Yuan** Well, it's something. On Sept. 28 the Chinese yuan broke through the 7.90 mark against the dollar. And notions that Beijing might loosen the monetary leash further were reinforced by People's Bank of China Governor Zhou Xiaochuan, who in *Caijing Magazine* on Oct. 3 called for greater flexibility driven by "market forces." That still may not soothe Washington hawks who think undervalued currency is to blame for China's massive trade surpluses. The yuan has gained only 2.6% against the dollar since July, 2005, when Beijing moved from a pegged rate to a managed float.



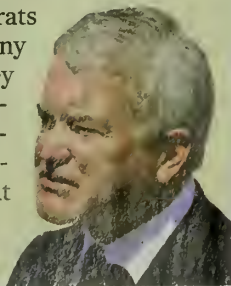
**Shock** It all started back in August with reports Dell laptops had caught fire. That led to a recall of Sony um-ion batteries in Dell machines. **Apple** soon followed. Then, on Sept. 28, Sony issued a global recall for the hy cells, triggering recalls by **Fujitsu**, **IBM**, **Lenovo**, and **ba**. The problem could affect up to 10 million comput- und cost the company \$500 million. Those numbers, bined with other Sony snafus, including delays on the video game system, have zapped the stock by nearly since Aug. 14.

**minum Allies** Move over, **Alcoa**. On Oct. 4, two Russ- aluminum giants, **Rusal** and **Sual**, along with Swiss commodities trader **Glencore International**, merged to be- e the world's No.1 producer. The merger is worth al- : \$30 billion and will create a colossus, also to be d Rusal, with annual output of some 4 million metric and revenues north of \$9 billion. It's the latest exam- of a drive led by **President Vladimir Putin** to create "na- d champions" in everything from energy to aerospace. **LINE** See "Russia sees the birth of an aluminum giant," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**ions Watch** **Apple** says its team did nothing wrong, ts captain still issued a mea culpa. The company on 4 reported that a board committee investigating the lling of options found irregularities in 15 instances be- n 1997 and 2002, but that no current executives en- d in misconduct. **CEO Steve Jobs** knew of some of the ents but didn't benefit from them. "I apologize to Ap- shareholders and employees for these problems, h happened on my watch," Jobs said. **Ex-CFO Fred rson** stepped down from the board.

## Scandal of the Week

tain the damage and change the subject: That ms to be the strategy of GOP leaders in dealing with elations that **Florida Representative Mark Foley** (photo) t sexually explicit e-mails to teenage boys who rked as House pages. **House Speaker Dennis Hastert** med Foley for lying to the leadership and asked the and Florida officials to investigate any possible ninal violations by the six-term lawmaker, who re- ned on Sept. 30 after being confronted with his e- mails by an ABC News reporter. Hastert, facing calls for resignation from some family-values conservatives, d to rally his base by telling **Rush Limbaugh** on Oct. 3 ut the record high on Wall Street and dangers to business of Democrats bbing control of the House. Many he corporate community feel they e a lose-lose choice come Novem- : a GOP majority beset by scan- s and charges of fiscal misman- ement, or a Democratic one that ht raise their taxes and poke o their industries.



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## LEADERSHIP

# CLEANED UP BUT FALLING BEHIND

Investors are carping about Citicorp's slow recovery. Can Chuck Prince pick up the pace?

**BY MARA DERHOVANESIAN**

**C**ITIGROUP INVESTORS aren't the only ones who are impatient with a stock that's going nowhere fast and a new investment strategy that has yet to pay off. "Get in line," quipped CEO Charles "Chuck" Prince, in an interview with *BusinessWeek* on Oct. 4. "It's not as good as I want it to be either."

Prince has faced one crisis after another during his three-year reign, from run-ins with regulators on three continents to shareholder lawsuits over Enron and WorldCom. And the Federal Reserve tied his hands, forbidding all acquisitions until he cleaned house. That's all behind him now. But he's not home free. And Prince is facing his biggest crisis ever—one of confidence in his leadership and his ability to steer a trillion-dollar empire toward desperately needed new growth. Profits have fallen short of analysts' estimates in four out of the last five quarters, and the stock has been stagnant for about three years.

Citi's U.S. consumer business, which has suffered after years of neglect, is behind much of the bank's woes. As some shareholders grumble that it may be time

for him to go, the 57-year-old chief executive acknowledges the discontent: "The concerns are perfectly legitimate," says Prince. "People are saying 'Do something!' They want to know how long is this guy going to take?"

An ethics cop was exactly what Citigroup needed when Prince took over in 2003. Citigroup founder Sanford I. "Sandy" Weill's voracious drive to create a financial powerhouse through rapid-fire acquisitions was spectacularly successful (page 128). But the effort to build revenues at all costs created a cowboy culture lacking in controls. Prince, a corporate lawyer for most of his career, starting at U.S. Steel in the 1970s, clamped down hard on rogue behavior and worked closely with regulators to get Citi back in their good graces.

With the ethics issues resolved, some people are wondering whether Prince's focus on rules and regulations is stifling the vitality of the company. "There are too many layers of bureaucracy, and he has a problem with generating momentum," says one former senior executive who declined to be named.

As a global financial services company, Citicorp is unrivaled in reach, yet it has

RAY BARTKUS



dropped to No. 3 from No. 1 in the credit-card business, and smaller retail banks are eating its lunch. In many cases, Citigroup lags behind in both revenue and profit percentage growth when measured against either retail bank rivals, such as Bank of America and JPMorgan Chase, or investment banks like Morgan Stanley or Goldman Sachs.

Some crave the return of a rainmaker as leader. "Maybe it's time for a management change to get this horse running again," says Carl Salvato, portfolio manager of money management firm Great Companies in Tampa, Fla., which has \$350 million in assets and holds 150,000 shares of Citi. "We've waited too long for results; it's extreme frustration."

## TIME TO CUT COSTS

INVESTORS SUCH AS Salvato will be happy to hear that Prince is dropping hints that he's revving up the deal engine again. He laments that for the past three years he had to stay out of the market and focus exclusively on making existing operations more profitable. "We're getting ourselves back on the playing field," he said, noting that most of the acquisitions will be in foreign markets. There's already chatter in London that he's eyeing Lloyds Bank PLC or BNP Paribas. Prince insists he's not interested in a big U.S. retail bank or mortgage company unless it's at a fire-sale price.

But deals alone aren't enough, and Prince concedes that. By all accounts, Citigroup is still a profit powerhouse. Earnings surged to \$24.6 billion last year, a 37.7% jump since December, 2003, the year he took over. But almost half of the company's businesses are under pressure to find new sources of growth, and recent investments have yet to pay off. Moreover, despite \$16.8 billion in stock buybacks and \$14 billion in dividend payouts in the last 18 months, the stock has hovered at around \$50 a share. Since Prince's appointment in October, 2003, shares are up just 8.6%, vs. 35% for the S&P 500 Financials Index. Bank of America Corp., with \$248 billion in total market value, is quickly closing in on No. 1 Citi, whose stock is worth \$252 billion.

One of the biggest complaints by investors and analysts alike is that Citi's expenses are growing faster than its revenues. In the second quarter, for example, revenues were up 9%, but ex-



## STALLED

Citigroup's stock has barely budged in the last few years

penses rose 15%. And only 2% of the cost increase was due to new investments, such as building up retail branches. Because the gap between expenses and revenues has been widening, shareholders—among them the bank's largest individual shareholder, Saudi Prince Alwaleed bin Talal—are up in arms. In an April interview with *BusinessWeek* columnist Maria Bartiromo, Prince Alwaleed said: "The grace period is over."

Citi's Prince says he got the message. In an internal memo sent to employees on July 22, he announced that he has asked business heads to evaluate every line item and squeeze out "business-as-usual" costs for items as small as newspaper subscriptions or travel. But he's vehement about not cutting investments to shortchange the future.

## Prince's plan: Nail the consumer biz and look abroad for acquisitions

Revamping the consumer business is absorbing most of Prince's focus now. The bank lags behind competitors in deposits by a mile (3% of the U.S. market, vs. 10% for BofA and 7% for JPMorgan). "If we don't grow consumer, the whole place has modest growth," he says. Prince is planning big branch expansions in locations where many cus-

tomers of the company's Smith Barney brokerage business live, hoping to sell them bank products. In Boston, for instance, Citi is planning to build 30 branches next year as a service to 30,000 Smith Barney clients. If it's successful, Citi

will roll out new branches in Philadelphia and a half-dozen other cities. If not, back to the drawing board, says Prince.

One well-regarded financial analyst says Citi's retail expansion is misguided. Building the consumer bank from scratch is "controversial, late in the cycle and in markets that are over-banked," says Merrill Lynch senior bank analyst Guy Moszkowski. "It's not convincing."

The man who put him in the job is exactly effusive when asked if he's handing over the reins to Prince. "I think Chuck is the best person I could have recommended to the board at that point in time.... I'm very hopeful that Chuck will end up being a great CEO," Weill told Bartiromo on Oct. 4. He says shareholders should be patient with Prince a bit longer. "I think it's been a pretty short time so far."

For now, the board is backing Prince too. Says Alain J. P. Belda, CEO of AIG Inc. and a Citigroup board member: "As a board member, this is a cultural shift of great magnitude.... 300,000 people transitioning their thinking is not an easy endeavor." Adds Robert E. Rubin, former Treasury Secretary and chairman of Citigroup's executive committee: "The period during which he had to deal with these regulatory issues probably did have a somewhat dampening effect. [But] it's behind us. I get a sense of people who are moving forward in their mindsets and energetic. Chuck certainly has the fire."

Some shareholders are willing to give Prince more time. "Investors are too patient. This is not an instant gratification story," says Yvonne M. Bishop, a





ager of the Summit  
est Fund. Citigroup  
es make up slightly  
e than 2% of the \$83  
on fund.

evertheless, Wall  
et analysts are frus-  
d by the lack of re-  
l. "They have made  
nises to investors...  
look very challenging  
hem to deliver," says  
k analyst Joe Dicker-  
of Atlantic Equities in  
lon, who on July 27  
is 2006 earnings esti-  
e to \$4.32 a share  
\$4.60. Michael L.  
o of Prudential Equity

up downgraded the stock in July to neu-  
partly because he thinks "Citigroup  
as to lack a catalyst [for growth]."  
Prince's strongest critics think the best  
to spur growth is to break up the fi-  
cial behemoth. Prince is dead set  
n it, but money manager William B.  
h of SAM Advisors in New York pro-  
s splitting the bank into three parts:  
l, investment banking, and global op-  
ons. He figures a breakup could push  
stock to 66 immediately, from 51 today,  
to 90 in two years. "Why does Prince  
k breaking up the company is 'the  
best thing he's ever heard?'" asks  
h. "Tyco did it, Altria did it."  
l eyes will be on Citi's third-quarter  
bers, due out on Oct. 19, to see if there  
been any progress since the end of  
Prince also plans to address in-



**SUPPORTER** Weill says  
patience is in order:  
"It's been a pretty  
short time so far"

vestors in a special conference call  
on Oct. 27 to explain the bank's  
investment strategy. Given the  
Street's reaction in recent quar-  
ters, Moszkowski thinks Citi is  
trying to do damage control: "It would  
certainly make you think that they are  
concerned that the numbers won't be well  
received, and they'll want to spend some  
time explaining the investments."

In defense of his record, Prince says in-  
vestments he made three years ago in  
Citi's capital markets business are now  
paying off nicely. In the second quarter of  
2006, the investment banking arm  
earned \$1.7 billion, up from \$1.37 billion  
in the same quarter last year. The invest-  
ment bank marked its 19th consecutive  
quarter as the No. 1 underwriter of com-  
bined debt and equity offerings. "The  
pendulum had swung pretty far to the  
conservative side," says Tom Maheras,  
CEO of Citi's Global Capital Markets  
group. "The balance between risk man-  
agement and innovation is back."

Prince's biggest challenge is to project  
himself as a leader with a vision. According  
to one senior manager at Citi: "Chuck's big  
weakness is that he hasn't been able to  
make his case to the world outside." Mean-  
while, talented people who are frustrated  
by the pace of growth are heading for the  
exits. A number of high-level executives,  
from advertising to investment banking,  
have left for such companies as Macy's,  
Barclays, and JPMorgan, taking underlings  
with them. "We are increasingly con-  
cerned about the people who are leaving  
throughout the ranks, and we're wonder-  
ing if Prince is the right guy to make this  
thing go," says Great Companies President  
Jim Huguet. Prince responds: "When you  
are making a lot of changes, you are by de-  
finition making someone unhappy." The  
bank says it has recruited many talented  
people to fill holes.

Of course, not everyone is pessimistic  
about Citigroup's prospects under Prince.  
Steve Neimeth, a senior portfolio manager  
at AIG SunAmerica Asset Management  
Corp., who manages more than \$800 mil-  
lion in assets, says the stock is a good buy.  
It has a 4% dividend yield and trades at  
roughly 11 times 2007 expected earnings,  
with an annual earnings-per-share growth  
rate of 8% to 10%. With help from a surge  
in the Dow 30 stocks, Citi hit a 52-week  
high of 51.03 on Oct. 4. Neimeth likens the  
recent underperformance of Citi's shares  
to that of Merrill Lynch or Morgan Stanley  
when those firms were undergoing man-  
agement upheavals: "You need to buy  
them when they are out of favor." ■

—With Maria Bartiromo in New York





**VEGAS, BABY**  
The takeover offer values the casino giant at \$26 billion

## BUYOUTS

# PRIVATE EQUITY: A BID TOO FAR?

Why Wall Street has doubts about the offer from Apollo and Texas Pacific for Harrah's

BY CHRISTOPHER PALMERI  
AND JANE SASSEEN

IT'S LIKE A BIG GAME OF POKER, and the prize at the center of the table is the world's largest casino company. On Oct. 2, Harrah's Entertainment Inc. revealed that it was the subject of an unsolicited takeover offer of \$81 a share, 22% higher than the previous closing price. The all-cash offer from buyout firms Apollo Management and Texas Pacific Group would value Harrah's at a staggering \$26 billion, including the \$11 billion of debt already on the company's books.

The size of the deal—potentially the fourth-largest leveraged buyout in history—surprised even longtime casino industry watchers used to profligate spending. “It’s an awfully attractive offer,” says Marvin Roffman, a onetime casino analyst

who’s now president of Roffman Miller Associates Inc., an investment advisory firm based in Philadelphia. Both of the companies declined to comment. But the likely lure is Harrah's roughly \$2.4 billion a year in earnings before interest, taxes, depreciation, and amortization, as well as a wide range of properties that could be sold to reduce debt.

But the deal may prove a hard sell. A few days after the takeover offer was made, the stock of the Las Vegas-based casino giant closed at \$75 a share, a sharp rise from the \$66 it was trading at before the offer but well below the \$81 buyout price. That suggests that Wall Street doesn't expect the deal to fly. The reg-

ulatory hurdles faced casino deals may partly explain the skepticism. But it likely also stems from the sense that firms are overreaching in tempting a buyout at this scale of such a highly regulated, debt-laden company.

If Harrah's accepts the takeover offer, it will extend private equity's record-shattering run this year. Seven of the largest buyouts of the time were announced in 2006, including hospital chain HCA Inc. for \$26 billion and energy pipeline company Kinder Morgan Inc. for \$26 billion. The size and scope of the buyouts are raising concerns about a potential wave of credit defaults down the line.

With so much money chasing deals, private-equity firms are pricing for perfection, even as they venture into unfamiliar areas. By then loading on debt, they leave little wiggle room should any problems emerge. And if companies can't generate enough cash to meet mounting interest payments, bankruptcy may loom.

Harrah's seems to be joining the Street in adopting a cautious stance. The committee of nonmanagement board members still evaluating the proposal “has determined that a transaction is in the best interests of Harrah's and its stockholders,” the company said in a statement.

A key catalyst for the buyout boom is one jaw-dropping statistic: As of early October, 436 new funds had raised a record \$300 billion worldwide in 2006, according to industry tracker Private Equity Intelligence. “Deal sponsors are hunting elephants,” says Chris Donnelly, who tracks leveraged loans for rating agency Standard & Poor's Leveraged

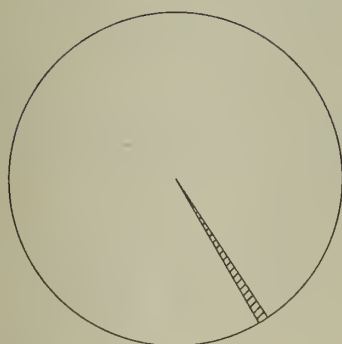
Commentary & Data, which, like *BusinessWeek*, is part of The McGraw-Hill Companies.

That helps explain why private-equity players are moving beyond their traditional stomping grounds into areas where they may confront complex new issues. Consider the regulatory hurdles in the proposed buyout of Harrah's: Since

**There's a growing sense that LBO players may be overreaching**



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does business in 13 states, the deal would have to be approved by 13 casino commissions, a process that could take years. Such reviews typically require proof that the proposed deal will result in a financially sound company that will contribute to the communities where it operates. In Nevada, the casino commission won't consider a merger proposal until shareholders approve the deal. In addition, principals at the two firms would have to undergo background checks before they can receive casino licenses. An investigation into reports that options on Harrah's shares surged before the buyout announcement could delay regulatory approvals even longer.

Then there are the worries that firms are overpaying. Martin Fridson, CEO of high-yield bond market strategist FridsonVision, points out that many private-equity firms are no longer buying "fixer-uppers" that can be radically restructured for huge gains. "There's not much room for improvement [in operations] and owners are getting top dollar," he says. "What will be achieved?"

Fridson and others also worry about private-equity firms piling too much debt onto companies. Credit defaults remain very low now, but many debt experts predict a big wave of defaults in a year or two. Credit quality has sharply deteriorated in the last couple of years, with more debt coming out at lower ratings. That has Fridson predicting that default rates will head back to peak levels seen in earlier bust cycles. Jay M. Goffman, a top bankruptcy lawyer with Skadden Arps

Slate Meagher & Flom, is also predicting a bust in coming years as a result of all the added risk. "It's coming, I can feel it in my bones," he says. "Everyone believes that their deals will work with lots of leverage, but history and economic cycles do repeat themselves."

In Harrah's case, new owners would eventually have to tackle problems that bedeviled its seasoned management. For many years, the company tried to be the Holiday Inn of the casino business, blanketing the country with nice but not too extravagant casino properties. The company's target market has been mid-market gamblers—the retiree who drives to Joliet for the night, rather than the high-roller arriving in Vegas by private jet.

## UPSCALE MISSTEPS

HARRAH'S NOW OWNS 37 casinos that fall under 12 different brands, including Bally's, Caesars, and Horseshoe. But it has never built the kind of giant casinos that wow Wall Street and attract gamblers from around the world. One attempt, the Harrah's in New Orleans, backfired when the company agreed to limit restaurant and entertainment venues in a deal with local businesses, and to pay \$100 million in taxes to the state. The casino couldn't meet its financial obligations and declared bankruptcy before Harrah's got full ownership in 2002.

Harrah's began taking steps to better integrate its portfolio when it hired Harvard Business School professor Gary P. Loveman as chief operating officer in 1998. Two years later, Harrah's launched its highly regarded Total Rewards loyalty program, which used database mining to target different classes of gamblers, mailing offers for free rooms, meals, and other discounts to gamblers based on their level of play.

Loveman, who acquired the upscale Caesars brand last year in a \$9.3 billion merger, had promised to extend Harrah's reach by adding new higher-

## Debt load aside, this deal's regulatory hurdles are formidable

end properties and freeing up older ones. That's crucial: If casinos don't net large chunks of cash sprucing up hotels, restaurants, gaming parlors, other amenities, they're seeing customers abandon them for the glitzier atmosphere next door.

So far, Harrah's attempt to launch snazzy new offerings have stumbled

megaproject expected to be announced in Las Vegas this summer was delayed, new projects in Spain, the Bahamas, and Slovenia failed to generate the same excitement as the fast-growing Asian markets, which Harrah's has been unable to crack. That was reflected in Harrah's stock price prior to the offer: It was down 6% for the year, while Las Vegas Sands, Wynn Resorts, and MGM Mirage were up 72%, 26%, and 5%, respectively.

Finding the cash to turn Harrah's into a more exciting operator could be tricky since buyout deals usually employ good leverage. According to S&P's Duff, the average ratio of a company's debt to earnings before interest, taxes, depreciation, and amortization in large leveraged buyouts has risen from just over 2 times in 2002 to 5.8 times by 2006's third quarter. More worrisome, the ability of companies to cover interest payments on the debt taken on in these deals is plummeting. In 2004, the ratio of EBITDA to interest charges was 3.4; it was below 2 in 2006's third quarter.

Apollo and Texas Pacific aren't sharing details of their financing, but a hefty debt load is a given. Peggy Holloway, the analyst at Moody's Investors Services covering gaming and hotels, figures that the investors put 20% in as equity and roughly \$5 billion at the purchase price—Harrah's would end up with about eight times its estimated 2005 cash flow of \$2.4 billion. If the deal is financed at an interest rate of 8%, the cash flow would cover just one and a half times its interest payments. With so little margin for error, Holloway questions whether Harrah's could spend enough to stay competitive.

All of which means that the bid for Harrah's, like a lot of deals, is aggressively priced. The economy has to chug along nicely, business strategies must pan out, asset sales have to fetch expected prices, and no unforeseen problems like weakening consumer spending can get in the way. Perhaps that's why Harrah's management and board isn't folding just yet. ■

## LEVERAGED BUYOUTS:

Candidates for the LBO Hall of Fame

Data: Thomson Financial





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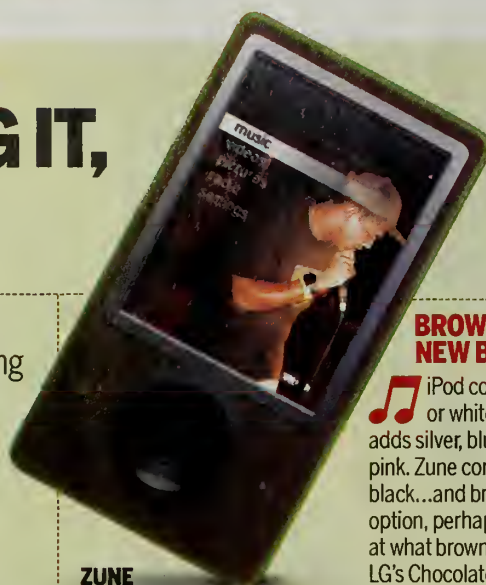
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## MP3 WARS

# BRING IT, ZUNE

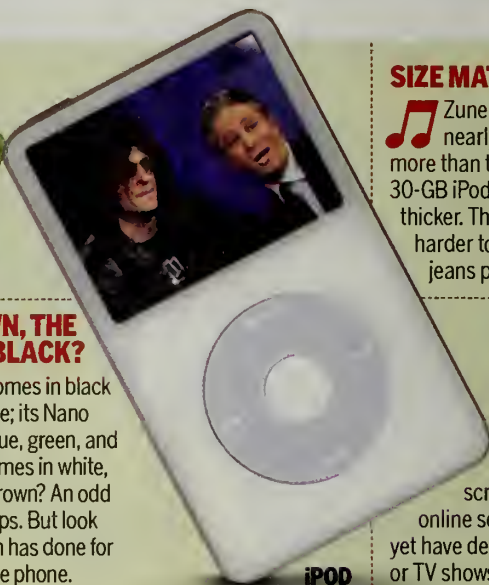
Microsoft has begun shedding light on its would-be iPod killer, the **Zune** music player. It will cost \$250 when available on Nov. 14—a price comparable to the iPod's. But Zune's success may hinge on other factors:



ZUNE

## BROWN, THE NEW BLACK?

🎵 iPod comes in black or white; its Nano adds silver, blue, green, and pink. Zune comes in white, black...and brown? An odd option, perhaps. But look at what brown has done for LG's Chocolate phone.



iPOD

## SIZE MATTERS

🎵 Zune checks in at nearly an ounce more than the comparably sized 30-GB iPod and a smidge thicker. That makes it a harder to slide into your jeans pocket.

## MOVING PICTURE

🎵 Zune plays video on a slightly larger screen, but its online service doesn't yet have deals to sell movies or TV shows, as iTunes does.

## ONE SIZE FITS ALL

🎵 At launch, Zune comes in a 30-gigabyte model, enough to hold 7,500 songs. The iPod family ranges from a tiny 1-GB shuffle to the capacious 80-GB player.

## PLAYS WELL WITH OTHERS...

🎵 In its most daring gambit, Zune includes Wi-Fi so you can swap songs with other Zuners. That opens the door to yet-to-be-announced features. But the Wi-Fi also sucks battery power.

## ...EXCEPT FOR APPLE

🎵 The iPod works with both Windows and Macintosh personal computers. The Zune? Microsoft says it's a Windows-only device.

## EXTRAS, EXTRAS

🎵 Zune debuts with a handful of accessories such as car stereo adapters. The iPod has thousands of them, including such esoterica as a toilet paper holder speaker system.

## ENERGY PRICES

# THE SHEIKS DON'T SHRIEK

Why the Saudis can live with cheaper oil

BY STANLEY REED

**U**NBELIEVABLE AS IT may sound, Saudi Arabia is practically applauding the 22% plunge in global oil prices since July. On Sept. 19, Saudi Oil Minister Ali Naimi called a price of about \$60 per barrel "reasonable." Some think the Saudis could live with even lower prices. "They are still happy at \$50 per barrel," says David Kirsch, an analyst at PFC Energy in Washington.

Why would the kingdom, which boasts the world's largest oil reserves, cheer a price slump? In fact, the Saudis never felt comfortable with \$70 oil, fearing that

sky-high prices might kill off the global appetite for their single source of wealth. "There is concern that the volatility in the markets is so beyond anyone's control that it could cause severe damage to the world economy," says Sadad Al Hussein, the retired exploration and production chief of Saudi Aramco, the national oil company. The Saudis, he says, "are determined to try and manage better."

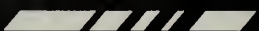
That's not to say the Saudis want to see prices continue to drop. In the short term, they're trying to keep them from crashing far below \$50 per barrel by gradually withdrawing oil from the market. But they're also investing tens of billions of dollars to build spare capacity. At a September

**KING ABDULLAH**  
The Saudis will boost capacity to manage prices

OPEC meeting in Vienna, Naimi said. Saudi Arabia plans to expand production in seven fields to add 2.4 million barrels per day of capacity, boosting its total to about 12.5 million barrels per day by 2009. Then on Oct. 1, the Saudis announced they would start work early next year on a new field called Moneefa, which will add another 900,000 barrels of capacity.

The Saudis want to be able to produce more so they can manage prices when supply and demand markets are tight and removing inventory when inventories fatten. Of the more than 100 OPEC production cuts, only the Saudis have significant spare capacity. Their buffer declined to around 700,000 barrels per day in 2004. It has since risen to about 1.5 million, still sizable but not enough to cover an outage in an



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er big producer. Like the rest of the industry, the Saudis were caught napping by the surge in demand that triggered a doubling of prices between 2004 and 2006.

The new production won't come cheap. The cost of expanding capacity will exceed \$24 billion, figures Nawaf Obaid, managing director of the Saudi National Security Project, a Riyadh consultancy. He says the Saudi leadership un-

der King Abdullah wants to "decouple energy and foreign policy" by building up enough capacity to make up for a cutoff of crude from Iran as well as another major producer such as Venezuela or Nigeria.

For now, Venezuela and Nigeria are co-operating with Saudi Arabia's short-term goal. Oil ministers from the two nations in late September promised to cut production by 170,000 barrels per day, which should help the Saudis steady prices without re-

ducing their own 30% share of OPEC production. But some market watchers think the Saudis will have to shoulder cuts of 1 million barrels per day or more to keep oil above \$50 per barrel. "We have seen the peak [in prices] for a while and something blows up," says Leo Drollas, analyst at the Center for Global Energy Studies in London. Even so, the Saudis want an insurance policy of extra capacity in case prices spike again. ■

## EDUCATION

# NO BUSH LEFT BEHIND

## The President's brother Neil is making hay from school reform

BY KEITH EPSTEIN

**A**CROSS THE COUNTRY, some teachers complain that President George W. Bush's makeover of public education promotes "teaching to the test." The President's younger brother Neil takes a different tack: He's selling to the test. The No Child Left Behind Act compels schools to prove students' mastery of certain facts by means of standardized exams. Pressure to perform has energized the \$1.9 billion-a-year instructional software industry.

Now, after five years of development and backing by investors like Saudi Prince Alwaleed Bin Talal and onetime junk-bond king Michael R. Milken, Neil Bush aims to roll his high-tech teacher's helpers into classrooms nationwide. He calls them "curriculum on wheels," or COWs. The \$3,800 purple plug-and-play computer/projectors display lively videos and cartoons: the XYZ Affair of the late 1790s as operetta, the 1828 Tariff of Abominations as horror flick. The device plays songs that are supposed to aid the memorization of the 22 rivers of Texas or other facts that might crop up in state tests of "essential knowledge."

Bush's Ignite! Inc. has sold 1,700 COWs since 2005, mainly in Texas, where Bush lives and his brother was once governor. In August, Houston's school board authorized expenditures of up to

\$200,000 for COWs. The company expects 2006 revenue of \$5 million. Says Bush about the impact of his name: "I'm not saying it hasn't opened any doors. It may have helped with some sales." (In September, the U.S. Education Dept.'s inspector general accused the agency of improperly favoring at least five publishers, including The McGraw-Hill Companies, which owns *BusinessWeek*. A company spokesman says:

"Our reading programs have been successful in advancing student achievement for decades; that's why educators hold them in such high regard.")

The stars haven't always aligned for Bush, but at times financial support has. A foundation linked to the controversial Reverend Sun Myung Moon has donated \$1 million for a COWs research project in Washington (D.C.)-area schools. In 2004 a Shanghai chip company agreed to give Bush stock then valued at \$2 million for showing up at board meetings. (Bush says he received one-fifth of the shares.) In 1988 a Colorado savings and loan failed



**CASH COW** The First Brother with his techie teaching aid

while he served on its board, making him a prominent symbol of the S&L scandal. Neil calls himself "the most politically damaged of the [Bush] brothers."

While hardly the first brother to embarrass a President—remember Bill Carter's Billy Beer or Roger Clinton's caine?—Neil could be the first to profit from a hallmark Presidential cascade. And also that of a governor: makes school standards a centerpiece in Florida, too.

Neil says he never talks shop with his brothers. He attributes his interest in education to his struggles with dyslexia. His son, Pierce, also had difficulties in school, he says. "Not one of our investors has ever asked for any kind of special access—a visa, a trip to the Lincoln Bedroom, an autographed picture, or anything." ■



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BIRGE





# The Organic Myth

Pastoral ideals are getting trampled as organic food goes mass market

BY DIANE BRADY

**NEXT TIME YOU'RE IN THE SUPERMARKET, STOP AND TAKE A** look at Stonyfield Farm yogurt. With its contented cow and green fields, the yellow container evokes a bucolic existence, telegraphing what we've come to expect from organic food: pure, pesticide-free, locally produced ingredients grown on a small family farm.

So it may come as a surprise that Stonyfield's organic farm is long gone. Its main facility is a state-of-the-art industrial plant just off the airport strip in Londonderry, N.H., where it handles milk from other farms. And consider this: Sometime soon a portion of the milk used to make that organic yogurt may be taken from a chemical-free cow in New Zealand, powdered, and then shipped to the U.S. True, Stonyfield still cleaves to its organic heritage. For Chairman and CEO Gary Hirshberg, though, shipping milk powder 9,000 miles across the planet is the price you pay to conquer the supermarket dairy aisle. "It would be great to get all of our food within a 10-mile radius of our house," he says. "But once you're in organic, you have to source globally."

Hirshberg's dilemma is that of the entire organic food business. Just as mainstream consumers are growing hungry for untainted food that also nourishes their social conscience, it is getting harder and harder to find organic ingredients. There simply aren't enough organic cows in the U.S., never mind the organic grain to feed them, to go around. Nor are there sufficient organic strawberries, sugar, or apple pulp—some of the other ingredients that go into the world's best-selling organic yogurt.

Now companies from Wal-Mart to General Mills to Kellogg are wading into the organic game, attracted by fat margins that

RICHARD BORG



old-fashioned food purveyors can only dream of. What was once a cottage industry of family farms has become Big Business, with all that that implies, including pressure from Wall Street to scale up and boost profits. Hirshberg himself is under the gun because he has sold an 85% stake in Stonyfield to the French food giant Groupe Danone. To retain management control, he has to keep Stonyfield growing at double-digit rates. Yet faced with a supply crunch, he has drastically cut the percentage of organic products in his line. He also has scaled back annual sales growth, from almost 40% to 20%. "They're all mad at me," he says.

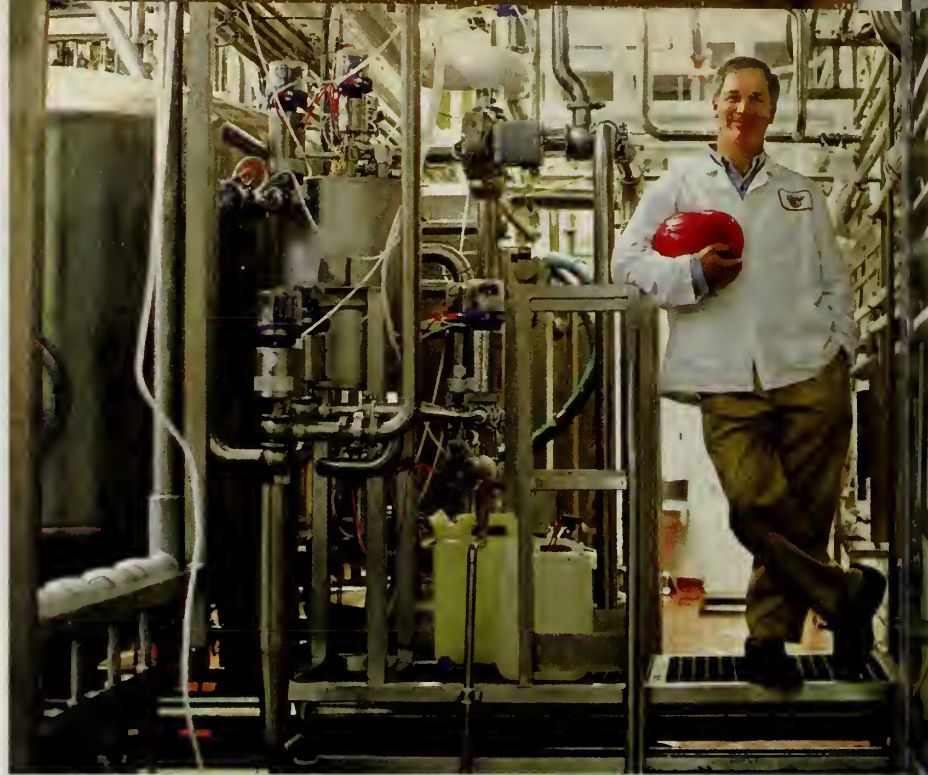
As food companies scramble to find enough organically grown ingredients, they are inevitably forsaking the pastoral ethos that has defined the organic lifestyle. For some companies, it means keeping thousands of organic cows on industrial-scale feedlots. For others, the scarcity of organic ingredients means looking as far afield as China, Sierra Leone, and Brazil—places where standards may be hard to enforce, workers' wages and living conditions are a worry, and, say critics, increased farmland sometimes comes at a cost to the environment.

Everyone agrees on the basic definition of organic: food grown without the assistance of man-made chemicals. Four years ago, under pressure from critics fretting that the term "organic" was being misused, the U.S. Agriculture Dept. is-

**HIRSHBERG** He reined in Stonyfield's annual sales growth because of a supply shortage

sued rules. To be certified as organic, companies must eschew most pesticides, hormones, antibiotics, synthetic fertilizers, bioengineering, and radiation. But for purists, the philosophy also requires farmers to treat their people and livestock with respect and, ideally, to sell small batches of what they produce locally so as to avoid burning fossil fuels to transport the goods. The USDA rules don't fully address these concerns.

Hence the organic paradox: The movement's adherents have succeeded beyond their wildest dreams, but success has imperiled their ideals. It simply isn't clear that organic food production can be replicated on a mass scale. For Hirshberg,



## Healthy Profits The big business of eating well

### DEAN FOODS

\$11 billion, Dallas

Owns such staples as **Horizon Organic**, **Rachel's Organic**, and **Organic Cow of Vermont**.

Criticized for running large corporate farms, it is reconfiguring an 8,000-cow Idaho facility to allow more grazing.

### GENERAL MILLS

\$12 billion, Minneapolis

The maker of **Trix** and **Häagen-Dazs** also boasts two major names in organic, **Cascadian Farm** and **Muir Glen**. "Consumers like boutique brands," says the head of its organic unit. "There's a feeling of authenticity."

### GROUPE DANONE

\$17 billion, France

The Paris dairy giant is majority owner of **Stonyfield Farm**, helping the yogurt maker expand distribution, acquire organic dairies in France and Ireland, and scour the world for organic ingredients.

### HAIN CELESTIAL

\$739 million, Melville, N.Y.

One of the original natural food companies, Hain owns **Earth's Best**, **Arrowhead Mills**, and **Walnut Acres Organic**. "I'm absolutely concerned about the ultimate supply" of organic ingredients, says CEO Irwin Simon.

### KELLOGG

\$10 billion, Battle Creek, Mich.

Along with producing organic versions of **Keebler** crackers and **Rice Krispies**, Kellogg acquired **Morningstar Farms Organic** and **Kashi**, which has an organic line.

### KRAFT FOODS

\$34 billion, Northfield, Ill.

Does the world need organic macaroni & cheese? Kraft thinks so, and it's expanding organic offerings through its **Back to Nature** and **Boca Foods** brands.

### MARS

\$18 billion, McLean, Va.

The privately held candy maker balances out its M&M's with the organic **Seeds of Change**, which boasts everything from frozen entrees to salad dressing.

### UNILEVER

\$50 billion, Britain/Netherlands

And you thought **Ben & Jerry's** was already organic! Just some of it—for now. Unilever also has organic versions of **Ragu** sauces, **Bertolli** products, and **Lipton** tea.



who set out to “change the way Kraft, Monsanto, and everybody else does business,” the movement is shedding its innocence. “Organic is growing up.”

Certainly, life has changed since 1983, when Hirshberg teamed up with a back-to-the-land advocate named Samuel Kaymen to sell small batches of full-fat plain organic yogurt. Kaymen had founded Stonyfield Farm to feed his six kids and, as he puts it, “escape the dominant culture.” Hirshberg, then 29, had been devoted to the environment for years, stung by memories of technicolor dyes streaming downriver from his father’s New Hampshire shoe factories. He wrote a book on how to build water-pumping windmills and, between 1979 and 1983, ran the New Alchemy Institute, an alternative-living research center on Cape Cod. He was a believer.

But producing yogurt amid the rudimentary conditions of the original Stonyfield Farm was a recipe for night-

mares, not nirvana. Meg, an organic farmer who married Hirshberg in 1986, remembers the farm as cold and crowded, with a so perilous that suppliers often refused to come up. “I call it my old days,” she says. Adds her mother, Doris Cadoux, who helped up the business for years: “Every time Gary would come home for money, Meg would call to say ‘Mama, don’t do it.’” Farming without insecticides, fertilizers, and other aids is tough. Laborers often weed the fields by hand. Farmers control pests with everything from sticky flypaper to aphid-munching ladybugs. Manure and soil fertility must be carefully managed. Organic animals may take longer to get well without a quick hit of

antibiotics, although they’re likely to be healthier in the first place. Moreover, the yield per acre or per animal often goes down, at least initially. Estimates for the decline from switching to organic corn range up to 20%.

Organic farmers say they can ultimately exceed the yields of conventional rivals through smarter soil management. But some believe organic farming, if it is to stay true to its principles, would require vastly more land and resources than is currently being used. Asks Alex Avery, a research director at the Hudson Institute think tank: “How much Bambi habitat do you want to plow down?”

## IMPOSSIBLE STANDARD

FOR A SENSE OF WHY Big Business and organics often don’t mix, it helps to visit Jack and Anne Lazor of Butterworks Farm. The duo have been producing organic yogurt in northeastern Vermont since 1975. Their 45 milking cows are raised from birth and have names like Peaches and Moonlight. All of the food for the cows—and most of what the Lazors eat, too—comes from the farm, and Anne keeps their charges healthy with a mix of homeopathic medicines and nutritional supplements. Butterworks produces a tiny 9,000 quarts of yogurt a week, and no one can pressure them to make more. Says Jack: “I’d be happiest to sell everything within 10 miles of here.”

But the Lazors also embody an ideal that’s almost impossible for other food producers to fulfill. For one thing, they have enough land to let their modest-sized herd graze for food. Many of the country’s

9 million-plus dairy cows (of which fewer than 150,000 are organic) are on





farms that will never have access to that kind of pasture. After all, a cow can only walk so far when it has to come back to be milked two or three times a day.

## STEWARDS OF THE LAND

WHEN CONSUMERS shell out premiums of 50% or more to buy organic, they are voting for the Butterworks ethic. They believe humans should be prudent custodians not only of their own health but also of the land and animals that share it. They prefer food produced through fair wages and family farms, not poor workers and agribusiness. They are responding to tales of caged chickens and confined cows that never touch a blade of grass; talk of men losing fertility and girls becoming women at age nine because of extra hormones in food. They read about pesticides seeping into the food supply and genetically modified crops creeping across the landscape.

For Big Food, consumers' love affair with everything organic has seemed like a gift from the gods. Food is generally a commoditized, sluggish business, especially in basic supermarket staples. Sales of organic groceries, on the other hand, have been surging by up to 20% in recent years. Organic milk is so profitable—with wholesale prices more than double that of conventional milk—that Lyle "Spud" Edwards of Westfield, Vt., was able to halve his herd, to 25 cows, this summer and still make a living, despite a 15% drop in yields since switching to organic four years ago. "There's a lot more paperwork, but it's worth it," says Edwards, who supplies milk to Stonyfield.

The food industry got a boost four years ago when the USDA issued its organic standards. The "USDA Organic" label now appears on scores of products, from chicken breasts to breakfast cereal. And you know a tipping point is at hand when Wal-Mart

Stores Inc. enters the game. The retailer pledged this year to become a center of affordable "organics for everyone" and has started by doubling its organic offerings at 374 stores nationwide. "Everyone wants a piece of the pie," says George L. Siemon, CEO of Organic Valley, the country's largest organic farm cooperative. "Kraft and Wal-Mart are part of the community now, and we have to get used to it."

The corporate giants have turned a fringe food category into a \$14 billion business. They have brought wider distribution and marketing dollars. They have imposed better quality controls on a sector once associated with bug-infested, battered produce rotting in crates at hippie co-ops. Organic products now account for 2.5% of all grocery spending (if additive-free "natural" foods are included, the share jumps to about 10%). And demand could rise if prices come down.

But success has brought home the problems of trying to feed the masses in an industry where supplies can be volatile. Everyone from Wal-Mart to Costco Wholesale Corp. is feeling the pinch. Earlier this year, Earthbound Farm, a California producer of organic salads, fruit, and vegetables owned by Natural Selection Foods, cut off its sliced-apple product to Costco because the supply dried up—even though Earthbound looked as far afield as New Zealand. "The concept of running out of apples is foreign to these people," says Earthbound co-founder Myra Goodman, whose company recalled bagged spinach in the wake of the recent *E. coli* outbreak. "When you're sourcing conventional produce, it's a matter of the best product at the best price."

Inconsistency is a hallmark of organic food. Variations in soil, animal diet, local conditions, and preparation make food taste different from batch to batch. But that's anathema to a modern food giant. Heinz, for one, had a lot of trouble locating herbs and spices for its organic ketchup. "We're a global company that has to deliver consistent standards," says Kristen Clark, group vice-president for marketing. The volatile supply forced Heinz to put dried or fresh organic herbs in its organic Classico pasta sauce because it wasn't able to find the more convenient quick-frozen variety. Even Wal-Mart, master of



### On the Farm, and Beyond

For a Video View with Stonyfield Chief Gary Hirshberg, an interview with Diane Brady, a look at the stink over China, and a slide show on some of the hottest organic products, go to [www.businessweek.com/extras](http://www.businessweek.com/extras). To see where organic products come from, watch our TV show, *BusinessWeek Weekend*. Check your local listings or go to [businessweekweekend.com](http://businessweekweekend.com).



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objection

sustained





ern food supply chain, is humbled by the realities of going organic. As spokesperson Gail Lavielle says: "You can't negotiate prices in a market like that."

While Americans may love the idea of natural food, they have to rely on the perks of agribusiness. Since the widespread use of synthetic pesticides began, around the time of World War II, food producers have reaped remarkable gains. Apples stay crisp and juicy for weeks. The average harvested acre of farmland produces 200% more wheat than it did 70 years ago. Over the past decades chickens have grown 25% bigger in less time and cost less food. At the same time, the average cow produces 60% more milk, thanks to innovations in breeding, nutrition, and genetic hormones. It's also worth remembering how inexpensive food is these days. Americans shell out about 10% of their disposable income on food, about half what they spent in the first part of the 20th century. Producing a budget-priced basket of organic food won't be easy.

**Threat A:** Gary Hirshberg's quest for organic milk. Dairy producers estimate that demand for organic milk is at least twice the currently available supply. To quench this thirst, the U.S. would have to more than double the number of organic cows—those that eat only organic food—to 280,000 over the next five years. That's a challenge, since the number of dairy farms has shrunk to 100,000, from 334,000 in 1980, according to the National Milk

#### **WAL-MART** Even the giant retailer feels the supply pinch

Producers Federation. And almost half the milk produced in the U.S. comes from farms with more than 500 cows, something organic advocates rarely support.

What to do? If you're Hirshberg, you weigh the pros and cons of importing organic milk powder from New Zealand. Stonyfield already gets strawberries from China, apple puree from Turkey, blueberries from Canada, and bananas from Ecuador. It's the only way to keep the business growing. Besides, Hirshberg argues, supporting a family farmer in Madagascar or reducing chemical use in Costa Rica is just as important as doing the same at home.

Perhaps, but doing so risks a consumer backlash, especially when the organic food is from China. So far there is little evidence that crops from there are tainted or fraudulently labeled. Any food that bears the USDA Organic label has to be accredited by an independent certifier. But tests are few and far between. Moreover, many consumers don't trust food from a country that continues to manufacture DDT and tolerates fakes in other industries. Similar questions are being asked about much of the developing world. Ronnie Cummins, national director of the nonprofit Organic Consumers Assn., claims organic farms may contribute to the destruction of the Amazon rain forest, although conventional farming remains the proven culprit.

Imported organics are a constant concern for food companies and supermarkets. It's certainly on Steve Pimentel's mind. "Someone is going to do something wrong," says Costco's assistant general merchandise manager. "We want to make sure it's not us." To avoid nasty surprises, Costco makes sure its own certifiers check that standards are met in China for the organic peanuts and produce it imports. Over at Stonyfield, Hirshberg's sister, Nancy, who is vice-president of natural resources, was so worried about buying strawberries in northeastern China that she ordered a social audit to check worker conditions. "If I didn't have to buy from there," she says, "I wouldn't."

For many companies, the preferred option is staying home and adopting the industrial scale of agribusiness. Naturally, gi-

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**COLORADO** The Aurora herd mainly lives in confined lots...



**VERMONT** ...while the Lazors' cows have space to roam

ant factory farms make purists recoil. Is an organic label appropriate for eggs produced in sheds housing more than 100,000 hens that rarely see the light of day? Can a chicken that's debeaked or allowed minimal access to the outdoors be deemed organic? Would consumers be willing to pay twice as much for organic milk if they thought the cows producing it spent most of their outdoor lives in confined dirt lots?

## ETHICAL CHALLENGES?

ABSOLUTELY NOT, say critics such as Mark Kastel, director of the Organic Integrity Project at the Cornucopia Institute, an advocacy group promoting small family farms. "Organic consumers think they're supporting a different kind of ethic," says Kastel, who last spring released a high-profile report card labeling 11 producers as ethically challenged.

Kastel's report card included Horizon Organic Dairy, the No. 1 organic milk brand in the U.S., and Aurora Organic Dairy, which makes private-label products for the likes of Costco and Safeway Inc. Both dairies deny they are ethically challenged. But the two do operate massive corporate farms. Horizon has 8,000 cows in the Idaho desert. There, the animals consume such feed as corn, barley, hay, and soybeans, as well as some grass from pastureland. The company is currently reconfiguring its facility to allow more grazing opportunities. And none of this breaks USDA rules. The agency simply says animals must have "access to pasture." How much is not spelled out. "It doesn't say [livestock] have to be out there, happy and feeding, 18 hours a day," says Barbara C. Robinson, who oversees the USDA's National Organic Program.

But what gets people like Kastel fuming is the fact that big dairy farms produce tons of pollution in the form of manure and methane, carbon dioxide, and nitrous oxide—gases blamed for warming the planet. Referring to Horizon's Idaho farm, he adds: "This area is in perpetual drought. You need to pump water constantly to grow pasture. That's not organic."

Aurora and Horizon argue their operations are true to the organic spirit and that big farms help bring organic food to the masses. Joe E. Scalzo, president and CEO of Horizon's owner,

WhiteWave, which is owned by Dean Foods Co., says: "We need the 12-cow farms in Vermont—and the 4,000 million cows in Idaho." Adds Clark Driftmiller, a spokesman for Aurora, which manages 8,400 dairy cows on two farms in Colorado and Texas: "We're in a contentious period with organics right now."

At the USDA, Robinson is grappling with the same impediments. In her mind the controversy is more about scale than animal treatment. "The real issue is a fear of large corporations," she says. Robinson expects the USDA to tighten pasture rules in the coming months in hopes of moving closer to the spirit of the organic philosophy. "As programs go," she says, "this is just a toddler. New issues keep coming up."

Few people seem more hemmed in by the contradictions than Gary Hirshberg. Perhaps more than anyone, he has become the industry's philosopher king, lobbying governments, proselytizing consumers, helping farmers switch to organic, and giving 10% of profits to environmental causes. Yet he has sold most of Stonyfield Farm to a \$17 billion French corporation.

He did so partly to let his original investors cash out, partly to bring organic food to the masses. But inevitably, as Stonyfield has morphed from local outfit to national brand, some of its original tenets have fallen by the wayside. Once Danone bought a stake, Stonyfield founder Samuel Kaymen moved on. "I never felt comfortable with the scale or dealing with people so far away," he recalls, although he says Hirshberg has so far managed to uphold the company's original principles.

The hard part may be continuing to do so with Danone looming over his shoulder. Hirshberg retains board control but his "autonomy and independence and employment are contingent on delivering minimum growth and profitability." Danone Chairman and CEO Franck Riboud expresses admiration for a man he considers to be Danone's organic guru, but adds: "I respect that I have to answer to shareholders."

The compromises that Hirshberg is willing to make say about where the organic business is headed. "Our kids don't have time for us to sit on our high horses and say we're not going to do this because it's not ecologically perfect," says Hirshberg. "The only way to influence the powerful forces in this industry is to become a powerful force." And he's willing to do that, even if it means playing by a new set of rules. ■





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**BY ROBEN  
FARZAD**



# Fidelity's Dive

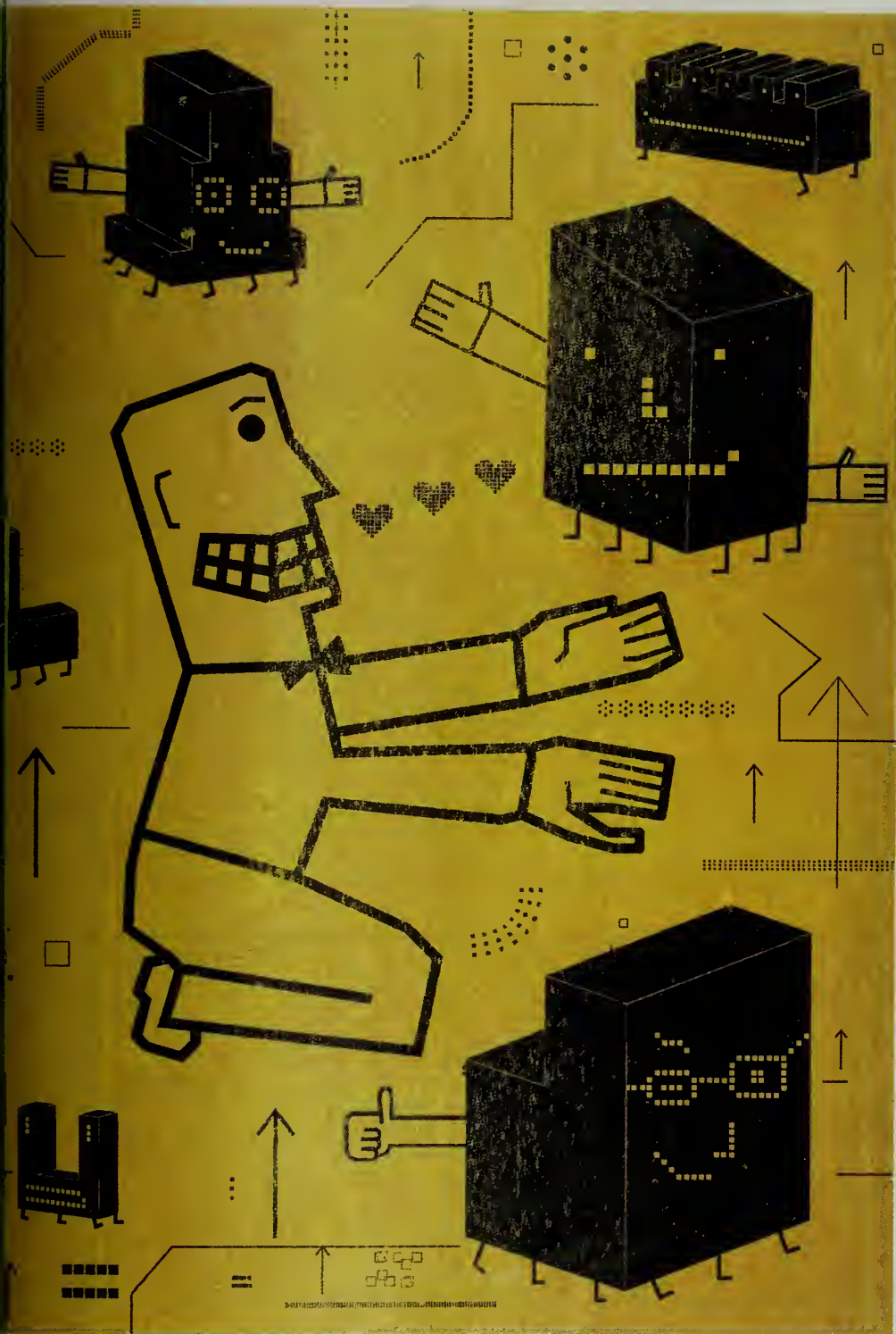


ILLUSTRATION BY JOHN HERSEY

# ed Loyalties



**A**MID ALL THE RECENT TURMOIL over corporate deceit, excessive CEO pay, and out-to-lunch company boards, one voice has been conspicuously quiet: that of Fidelity Investments, the world's largest mutual fund firm. Fidelity holds a 10% or greater stake in at least 100 of the nation's largest 1,000 companies and, all told, controls at least \$1.3 trillion, more than all hedge funds combined. But Fidelity rarely exercises its unprecedented muscle to push for improved corporate governance.

Traditionally, most mutual fund companies have backed the management of the companies whose shares they hold. But during the past five years of tumult over corporate leadership, some of Fidelity's rivals have been more aggressive in challenging the behavior of CEOs in the name of seeking better corporate performance and improved results for mutual fund customers. Fidelity's hands-off strategy now sets it apart.

So does the evolution of its overall business strategy. No longer mainly a mutual fund provider serving individual investors, Fidelity also serves corporations as a manager of both retirement plans and, increasingly, a whole host of business outsourcing services, from payroll to health and welfare.

In theory, at least, these two distinct lines of business can come into conflict: Does Fidelity primarily serve its corporate customers, whom it would be loath to challenge over governance issues? Or does it stick up for its individual customers, whose interests might be better served by a more activist stance toward corporate management? The evidence shows



## THE ISSUE

A 1998 shareholder resolution to seek a majority of directors for Tyco's board without ties to management.

## THE VOTES

Fidelity voted against the resolution, which was supported by 15 fund institutions.

## OTHER BUSINESS

Fidelity was a manager of Tyco's employee benefit plans.

that in recent years, Fidelity has forgone the opportunity to join other large mutual fund companies—even ones that offer corporate 401(k) plans—in pushing for better governance.

Fidelity's behavior as a shareholder probably would merit much attention were it not for one other development: the deterioration of its funds' performance. Once an industry achiever, Fidelity has descended to mediocrity. Only 39% of its actively managed stock funds beat their category averages through the first eight months of 2006, according to fund tracker Lipper Inc. Over the past five years, fewer than half

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Data: Pensions & Investments

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Fidelity has many businesses

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Fidelity equity portfolios have beaten the average of their peer groups. The performance has been so poor that the company says it is significantly increasing its spending on stock research.

## Pro-Company

FIDELITY SAYS ITS investment management and corporate benefits units run entirely independently of one another and that there is no conflict, theoretical or actual, that could harm individual customers. But the decline of Fidelity's mutual fund returns during an era of sharply increased skepticism about corporate management naturally raises the question of whether Fidelity's big lines of business now clash. A close look at recent corporate controversies illustrates that Fidelity has frequently declined to join its rivals and other investors in confronting dubious company management.

Because of a 2003 Securities & Exchange Commission rule that Fidelity and others opposed, mutual fund firms now must disclose their proxy voting records by Aug. 31 of each year. Taken in isolation, Fidelity's record doesn't illuminate much; the act of buying a stock, and holding on to it, is inherently a vote of confidence. But in the context of its peers, Fidelity's votes seem disproportionately pro-company.

Case in point: semiconductor maker Analog Devices Inc., which is embroiled in the options backdating scandal that has hit more than 130 companies this year. In February the company revealed that its CEO was granted \$145 million in unconventional deferred compensation; it's also facing SEC and U.S. Attorney probes into its options practices. Analog says the compensation number is a long-term cumulative total that includes, among other things, exercised stock options. The stock has shed 37% since the news broke. Fidelity and T. Rowe Price tied for top share ownership—8% each—when they cast



### THE ISSUE

Options backdating. Analog Devices is facing SEC and U.S. attorney probes into its options practices.

### THE VOTES

At proxy time, Fidelity voted for the only director on the compensation committee up for reelection.

### OTHER BUSINESS

Fidelity manages Analog's 401(k) plan

## Fidelity has declined to join its rivals in confronting dubious management

their proxy votes at the company's March annual meeting. T. Rowe withheld its vote for the only compensation committee member up for reelection. It also went against management to back a shareholder proposal that would require a majority vote for directors. (Shareholders can vote for or against proposals, but for director candidates, they can either vote for a candidate or, to protest, withhold their vote.)

In contrast, Fidelity voted for all directors and against shareholders across all of its actively managed portfolios. According to government filings from the most recent period, Fidelity manages Analog Devices' 401(k) plan. Notably, two Fidelity-branded index funds did oppose management on two proposals, but those funds are actually run by an outside company with its own proxy voting system. Fidelity declined to comment on any company-specific votes.

Fidelity's management-friendly voting pattern goes back

many years. Consider Tyco International, a famous example of corporate misgovernance. In 1998, before vote disclosure was required of mutual fund firms, Fidelity was Tyco's largest shareholder, with a 14% stake. According to government filings, it also earned \$1.8 million on Tyco employee benefit administration. A shareholder proposal called for a majority of Tyco directors to be financially and personally independent from executives—something that 15 other institutional investors voted for. Fidelity instead sided with management, disclosing its vote in a survey taken by a labor group. Tyco subsequently lost \$80 billion of market value in the controversy.

over executives using millions of dollars of shareholder money for personal expenses. SEC sued three directors, two of whom were executives.

Fidelity lays out its proxy voting guidelines, which

approved and overseen by the funds' board of trustees, carefully worded document that's available on its Web site. It acknowledges the issue of corporate governance explicitly: "Fidelity believes that there is a strong correlation between enhancing shareholder value and sound corporate governance. But it also makes its predilection to side with management crystal clear. It says it "will generally vote in favor of incumbent and nominee directors except where a director has failed to exercise reasonable judgment."

Fidelity never promised to be a crusader, and it isn't about to start now. "The notion that we should be governance activists is not a leap we'll make," says Stephen P. Jonas, executive director of Fidelity Management & Research Co., the investment management arm. "The sole beneficiaries of publicly disclosed proxy votes are special interest groups with axes to grind with companies." Fidelity says it votes with its fiduciary

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meaning it simply sells shares when it strongly disagrees with decisions a company has made.

Fidelity does, however, draw a distinction on compensation matters. It says it voted against management proposals on one narrow subset of executive pay, stock compensation proposals, 54% of the time between 2005 and 2006, and notes that the number would have been 65% had it not been successful in negotiating with companies to conform to its proxy guidelines. The policy reads: "Fidelity encourages the use of reasonably designed stock-related compensation plans that align the interests of corporate management with those of shareholders by providing officers and em-

Depot. The retailer says none of the board relations influence Fidelity's decisions.

But it is public record that Home Depot's board includes many directors who handle the purse strings at other companies that are Fidelity clients. Director and compensation committee member Angelo R. Mozilo is also CEO of Country Financial Corp., a Fidelity client, according to governance filings. John L. Clendenin, the chair of Home Depot's a committee and a member of its compensation and executive committees, is lead director at Powerwave Technologies, a Fidelity client. There are at least two other such cross-management relationships involving members of Home Depot's board.

Says a former Fidelity fund manager: "The thing they're going to do is vote against a director who helps hire another company's benefits manager."

Still, Fidelity insists there's no conflict whatsoever between the fund management and the benefits groups. "I don't pay any attention to who the [corporate] clients are," says Jonathan J. Jona, Fidelity's director of corporate relations. "I don't care who they are." Others doubt there's any coordinated relationship between votes and corporate clients. "There's no way a portfolio manager will vote for something that's bad for [his or her] fund or for another department's client isn't annoying," says Robert McCormick, a former director of investment proxy research at Fidelity who is now vice-president of proxy research and operations at advisory firm Glass, Lewis & Co. in San Francisco.

But Fidelity's pro-director voting pattern persists even when there's reason to suspect egregious governance abuses. Consider UnitedHealth Group, which, like Analog, is mired in an options-backdating scandal. In March, questions arose about the timing of the company's options grants over several years. In April, upon revealing an SEC inquiry, the company

conceded a "significant deficiency" in its options program and acknowledged that could potentially result in its having to restate earnings from the past several years, marking the first time by as much as \$286 million. Multiple shareholder lawsuits followed. UnitedHealth denies any impropriety.

Fidelity was UnitedHealth's largest holder as of March, with 128 million shares, 9.5% of the total. The company's stock price fell by as much as 31% at one point—erasing \$20 billion in value. Fidelity sided with management on all proposals and directed candidates at UnitedHealth's May 2 meeting and voted against a shareholder proposal requiring future board members to be elected by a majority vote.

By comparison, T. Rowe Price's biggest shareholding fund withheld a vote for a board member from the fund that held its biggest position, 7 million shares. Vanguard, the ninth-largest shareholder, withheld votes from a director who sat

## Gentle Giant

Fidelity's frequency in voting\* for shareholder-sponsored:

COMPENSATION PROPOSALS:



STOCK OPTION EXPENSING PROPOSALS:



PROPOSALS URGING PERFORMANCE-BASED STOCK OPTIONS:



PROPOSALS TO CAP SEVERANCE OR GOLDEN PARACHUTES:



\*BETWEEN JULY 1, 2004, AND JUNE 30, 2005 \*\*PEER AVERAGE INCLUDES 18 FUND ORGANIZATIONS  
Data: Corporate Library, American Federation of State, County and Municipal Employees; AFL-CIO

ployees with incentives to increase shareholder value."

In some cases, it's hard to reconcile that policy with Fidelity's voting record. In 2003, Home Depot's board changed CEO Robert L. Nardelli's compensation structure to weaken its link to stock performance. By the May, 2006, shareholder meeting, some were furious that Nardelli had received more than \$200 million in compensation in the five and a half years since he joined the company—a period during which the stock lost \$23 billion in market value.

## Board Ties

T. ROWE PRICE, HOME DEPOT'S ninth-largest shareholder, withheld votes from 10 of 11 board members, and voted for shareholder proposals seven out of eight times. "We were not happy with some of their corporate governance...and the company changing its compensation policy midstream," says portfolio manager Anna M. Dopkin, who co-chairs T. Rowe's proxy committee. Similarly, Putnam Investments, the No. 10 shareholder, withheld votes from all of management's candidates and voted for seven of eight shareholder proposals.

In contrast, Fidelity, which among mutual fund firms had the largest ownership of Home Depot's shares, at 5%, voted with management and against every shareholder resolution. Fidelity would not disclose outside business ties to Home

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on both the audit and compensation committees, and another who sat on the board's nominating committee.

Again, Fidelity has outside business ties to key directors. James A. Johnson sits on United's audit and compensation committees; he also sits on the board of KB Home, a Fidelity benefits client that also counts Fidelity as its second-largest shareholder among mutual fund firms. Compensation committee member Gail R. Wilensky sits on the board of Quest Diagnostics, a Fidelity client. All told, UnitedHealth board members were affiliated with at least nine Fidelity clients.

## Avoiding the Subject

OF COURSE, FIDELITY MAY simply have been voting in favor of a board that has performed well for fundholders over time. Despite the recent sell-off, UnitedHealth shares have more than tripled in 10 years. "If we don't like the stock, we're gone," says Eric D. Roiter, general counsel for Fidelity's investment arm. "Withholding votes is a moot point." Yet Fidelity was still UnitedHealth's top shareholder as of June, the most recent date for which data are available. On the subject of options backdating, Roiter says: "Some [of it] could be illegal. Some could be legal. We're against illegal backdating."

Fidelity could, of course, withhold votes from a company's directors while still holding its stock. Roiter points to the withholding guidelines in Fidelity's proxy policy, which cite specific cases of poison pill plans, the repricing of underwater stock options, and failing to act "in the best interest of shareholders when approving executive compensation." By and large, Fidelity would rather avoid the subject altogether. "We have more discreet ways to convey unhappiness over compensation," says Roiter. "Deciding to withhold is a big weapon."

Fidelity is somewhat more willing to take on companies in Europe, where its controlling family owns just under half of Fidelity International. But even on the other side of the Atlantic,

**"If we don't like the stock, we're gone. Withholding votes is a moot point."**

Fidelity seems reluctant to make too much noise.

In one case it decided to jump on the back of a smaller investor rather than raise a ruckus itself, effectively outsourcing its shareholder advocacy. When Netherlands-based media firm VNU waffled on making a big acquisition, Fidelity, whose Boston and International operations were amassing a 15% share position, took action—sort of. It contacted Knight Vinke Asset Management, a hedge fund that held a 2% stake in VNU. Fidelity "suggested we take a look at it," says Knight Chief Investment Officer Eric Knight.

Knight did, incurring what he estimates were 4,000 man hours of labor and other high expenses, including the cost of hiring a consulting firm to analyze VNU's operations. "We paid for everything," he says. Knight aggressively confronted VNU with press releases and letters to management, cajoling it to buy back stock or put itself up for sale.



### THE ISSUE

Home Depot paid its CEO \$200 million over five years. It weakened the link between pay and performance in 2003.

### THE VOTES

Fidelity voted all of its shares with management and against all eight shareholder resolutions.

### OTHER BUSINESS

Fidelity has outside business ties to at least four Home Depot board members.

Fidelity International chimed in three months later with short statement opposing VNU's plans to buy a company VNU was ultimately sold to a private equity group.

Could Fidelity, with its many resources, have gone it alone? Fidelity International declined to comment. Knight's explanation: "They could in theory. But that's not their business. We're not managing corporate pensions, so we don't have the conflicts."

All told, Fidelity says it withheld votes from at least one director at 73 companies in the 2005-2006 season, out of a total of about 6,000 company meetings. It says it withheld votes from directors of "key clients" more frequently than for directors of "non key clients."

Fidelity is more likely to vote with shareholders on other matters, but only marginally so in many cases. A 2005 study by the *Journal of Financial Economics* showed Fidelity voting in favor of key shareholder proposals and against management recommendation at the nation's largest 1,000 companies 33% of the time

between 2003 and 2004—the lowest of two dozen institutions analyzed. That compares with 51% for Vanguard, 67% for T. Rowe Price, and 70% for American Funds—all big 401(k) players.

Similarly, a March, 2006, study of mutual fund voting patterns from July 1, 2004, to June 30, 2005, by the Corporate Library and two labor groups found that Fidelity voted on shareholder proposals involving executive compensation at a rate less than 1/12th the average of the 18 funds examined. Fidelity voted for stock options expensing measures 5.3% of the time, compared with the peer average of 74.8%. It never voted to tie options pay more closely to company specific performance. And only one other firm was likely to vote against capping severance and golden parachutes for executives.

Fidelity says that for the 2005-2006 proxy voting season





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contrary to one or more management proposals at 31% of U.S. company meetings at which it voted. That percentage held what it calls "key clients" and "not key clients" alike.

Some former Fidelity employees say the firm's general stance to take on companies is emblematic of a bigger, longer-term problem: the decline of a performance-driven culture. One former manager recalls how in its early-1990s heyday, star managers such as Peter Lynch would take a cub analyst to dispense variations of one overriding theme: "If you can't find two or three great stocks in your universe of coverage, you're not doing your job."

## Marketing Emphasis

A LEADERSHIP CHANGE and the ouster of a risk-taking manager in 1996—combined with Fidelity's growing corporate benefits business—sent a new message. Fidelity moved into "a marketing organization that was about where it could get the next 401(k) customer," says one former insider. It chased away performance[-oriented] people and left the people who just wanted a big, safe place to work." Fidelity now appeals to individuals who seek out its funds and others who are there strictly because Fidelity manages their company's 401(k). "Defensiveness crept into the place the larger it got," says a former manager. "Now they just want to be close to the benchmark. Performance doesn't matter as much as babysitting assets." Fidelity's Jonas, who took over the fund business a year and a half ago, doesn't deny the mid-'90s emphasis on stability, which he says was industrywide. Now he says boosting returns is the goal. "We frankly were not happy with domestic equity

[performance], which was mediocre," he says. "We came in to make serious investments to get performance on par." He says the firm is plowing \$100 million into equity research, much of it for U.S. staff.

But \$100 million isn't much compared with the enormous fees Fidelity collects even on underperforming funds. Take the \$45 billion behemoth, Magellan. The fund is no longer open to outside investors but still accepts money from 401(k) participants. It has lagged the benchmark Standard & Poor's 500-stock index in 8 of the past 12 years. Yet Magellan holders have paid about \$5.2 billion in fees since 1996. "There's certainly a lot more Fidelity could be doing for its money," says Jeffrey M. Cohn, managing partner at New York-based Bench Strength Advisors, which advises institutions on performance.

Fidelity's Jonas says Magellan is a work in progress. A spokeswoman says that if Fidelity's fundholders don't believe in the firm, they, too, can vote with their feet by taking their money elsewhere. Of course, many can't—all they have are their corporate retirement accounts.

And more such customers are coming down the pike. In August, President George W. Bush signed into law a pension reform bill that will channel great sums to the retirement benefits industry by making enrollment in corporate 401(k) savings plans automatic, with customers required to opt out if they don't want to participate. As a result of the new law, the Investment Company Institute projects that 401(k) participation will increase from its current level of 66% of employees at businesses that offer them to 92% over the next several years, dramatically boosting assets from the current \$2.4 trillion. Like it or not, Fidelity is about to get even bigger. ■

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Sharing the wealth, listening to even the lowest-ranking workers, and rewarding risk have paid off big time. **BY GAIL EDMONDSON**

# BMW'S DREAM FACTORY

**T**HE CAR LOOKS LIKE THE VICTIM OF SOME MAD scientist's experiment gone awry. Inside a research lab in Munich, a BMW 5 Series sedan is splayed open, with electronic gadgets and wires spewing in all directions. The project: an onboard computer that will recognize you, then seek out information you want and entertainment you love. While you sleep, your BMW will scour the Net—via Wi-Fi and other connections—collecting, say, 15 minutes of new jazz followed by a 10-minute podcast on the energy industry. It may sound far-fetched, but for BMW's research wizards it's yet another way to woo customers by personalizing cars. This intelligent machine will grow to know you better every day, constantly learning what you like by monitoring your choices. The brains of the system might even tag along with you on a business trip in the form of a "smart card," instructing the Bimmer you rent in Beijing to load up your daily fix of news and music. ¶ When Hans-Joerg Vögel, the 38-year-old project chief, hops in the car's front seat and fires it up, his excitement is palpable. Launching into a riff on the wonders of melding the virtual world with the nuts and bolts of an automobile, Vögel says the next generation of BMW 5 Series and 7 Series sedans will be the





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most Net-savvy cars on the road. And if he's right, it'll be because Vögel had the vision to see the importance of the technology and the gumption to build it so everyone at the automaker could recognize its potential. "We are encouraged to make decisions on our own and defend them," says Vögel. "Risk-taking is part of the job."

Vögel's project is only a tiny part of BMW's vast innovation machine. Just about everyone working for the Bavarian automaker—from the factory floor to the design studios to the marketing department—is encouraged to speak out. Ideas bubble up freely, and there is never a penalty for proposing a new way of doing things, no matter how outlandish. BMW, says Ulrich Steger, a professor of management at the International Institute for Management Development in Lausanne, Switzerland, is "a fine-tuned learning system."

## True Believers

THAT'S NO SMALL ACCOMPLISHMENT, and it has fueled BMW's growth over the past decade from a boutique European automaker to a global leader in premium cars. Although BMW, with \$59.2 billion in sales last year, is much smaller than its American rivals, the U.S. auto giants could still learn a thing or two from the Bavarians. Detroit's rigid and bloated bureaucracies are slow to respond to competitive threats and market trends, while BMW's management structure is flat, flexible, entrepreneurial—and fast. That explains why, at the very moment GM and Ford appear to be in free fall, BMW is more robust than ever. The company has become the industry benchmark for high-performance premium cars, customized production, and

savvy brand management, making it the envy of Mercedes-Benz, Audi, and Lexus and the subject of Harvard Business School case studies. Even mighty Toyota Motor Corp. regularly dispatches engineers to BMW's factories to see how the company cranks out 1.3 million custom cars a year.

Few companies have been as consistent in producing ever-changing products with near-flawless quality, that consumers crave. BMW

has redefined luxury with its 7 Series, created a mania for its Mini, and maintained some of the widest margins in the industry. A sporty four-wheel drive coupe and a svelte minivan called the Luxury Sport Concept are slated to roll off the production line in 2008. Those models promise to continue BMW's run of cool cars under its chief executive, Norbert Reithofer, who took over in September. (His predecessor, Helmut Panke, stepped down upon reaching the mandatory retirement age of 60.) Says Reithofer: "We change through the organization to ensure its strength. There are always better solutions."

Virtually everyone at BMW is expected to help find those solutions. When demand for the 1 Series compact soared, plant manager Peter Claussen volunteered to temporarily use a brand new factory—which had been designed for the 3 Series—to crank out 5,000 of the compacts, and he quickly figured out how to do it while maintaining all-important quality. Last year line workers in Munich suggested adding a small diesel engine in the 5 Series, arguing that it would have enough oomph to handle like a Bimmer and be a big savings among those on a tighter budget. They were right. And Panke once insisted that all six members of the management board take an advanced driving course so they would have a better feel for BMW cars.

Much of BMW's success stems from an entrepreneurial culture that's rare in corporate Germany, where management is usually top-down and the gulf between workers and managers is vast. BMW's 106,000 employees have become a nimble work of true believers with few hierarchical barriers to their innovation. From the moment they set foot inside the company, workers are inculcated with a sense of place, history, and mission. Individuals from all strata of the corporation work

## A Peek Under the Hood

**GREATEST HITS** The cars that have made BMW one of the most respected automakers on the planet

**THE SECRET OF ITS SUCCESS** BMW's reputation is grounded in the company's unique management culture

**DESIGNER IN CHIEF** Adrian van Hooydonk is the man behind BMW's fresh new looks

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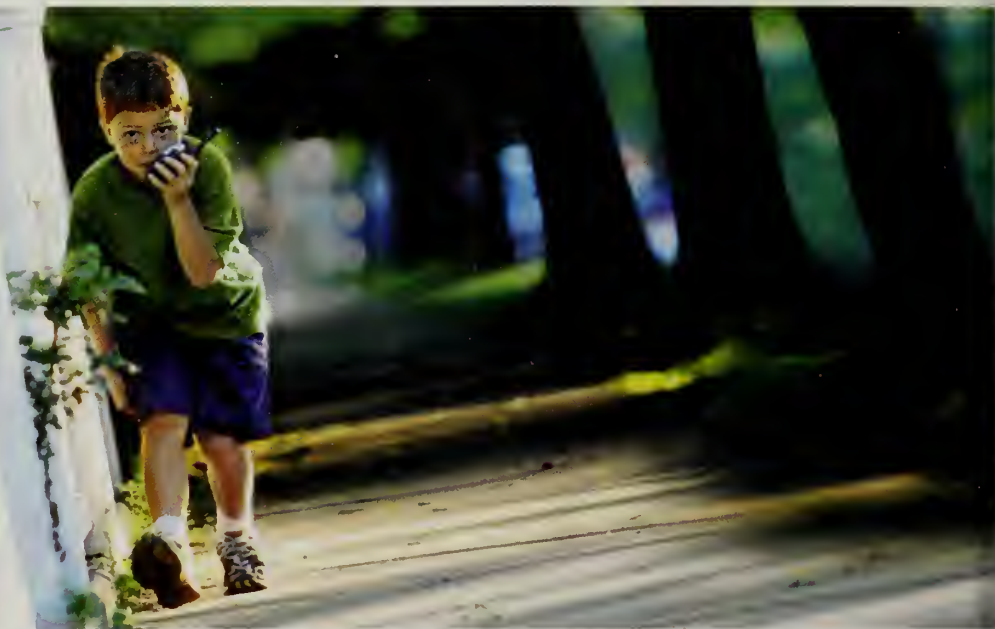
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to elbow, creating informal networks where they can even the most unorthodox ideas for making better Bim- or boosting profits. The average BMW buyer may not v it, but when he slides behind the wheel, he is driving a hine born of thousands of impromptu brainstorming ses- s. BMW, in fact, might just be the chattiest auto company "The difference at BMW is that [managers] don't think ave all the right answers," says Claussen, manager of the pany's new Leipzig factory, a 21st century cathedral of and air designed vant garde archi- Zaha M. Hadid. Job is to ask the questions."

may sound trite, it sure seems to Last year the pany sprinted past tumbling archi- Mercedes-Benz, in al sales of its s, Minis, and -Royces. (The nan company ht the Rolls name 99.) More impres- BMW's 8.1% ating margins e the automaker of the most prof- e in the industry. he first half of BMW's sales 10.2%, to \$32 bil- while pretax earn-umped 44.5%, to billion, despite a g euro and punishing increases in raw material costs.

at's not to say this freewheeling idea factory hasn't made are of blunders over the years. In 2001, BMW alienated mers with its iDrive control system. The device was de- d to help drivers quickly move through hundreds of in- ation and entertainment functions with a single knob, but ved incomprehensible to many buyers. That misstep could minor, though, if BMW were to fail to artfully navigate the enges ahead. Rival Audi is narrowing the gap with BMW in pe by churning out a new generation of stylish, high-per- formance cars that have topped consumer polls. Toyota's Lexus

also has BMW in its sights as it makes a move to gain in Europe with sportier, better-handling cars. "We will be challenged—no question," says Reithofer. "We have to take Lexus seriously."

A profit squeeze could just as easily trip up the company in the eyes of investors. To prove he has the right stuff, Reithofer is going to have to boost margins even as the cost of materials soars. Down the line the high price of oil and concerns about global warming could make "the ultimate driving machine" a lot less appealing when compared with gas-sipping, eco-friend-

ly cars. The premium market "means extravagance by definition," something consumers may start to reject, says Garel Rhys, a professor of automotive economics at Cardiff University in Wales. Yet BMW's greatest danger could be its own growth and success. Says Ralf Kalmbach, a partner at Munich management consultant Roland Berger: "Losing its culture to sheer size is a major risk."

In BMW's favor is an enduring sense that things can go badly wrong. New hires quickly learn that the BMW world as they know it began in 1959. That's when the company nearly went

bankrupt and was just a step away from being acquired by Mercedes. That long-ago trauma remains the pivotal moment in BMW folklore. "We never forget 1959," says Reithofer. "It's in our genes, and it drives our performance." If it weren't for a bailout by Germany's wealthy Quandt family—still the controlling shareholder, with a 46.6% stake—and a pact with labor to keep the company afloat, BMW wouldn't exist today. "Near-death experiences are very healthy for companies," says David Cole, a partner at the Center for Automotive Research in Ann Arbor, Mich. "BMW has been running scared for years."

The story of 1959 is told and retold at each orientation of new

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### Bottom Up At **BMW** How to build a culture of innovation

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New hires learn about 1959, when BMW nearly went bankrupt. Its recovery remains the centerpiece of company lore, inspiring a deep commitment to innovation.

#### WORK OUTSIDE THE SYSTEM

The sleek Z4 coupe exists because a young designer's doodle inspired a team to push his concept even though management had already killed the program.

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**ON THE FLOOR** When Leipzig plant manager Claussen (right front) first proposed a competition to lure top architects, headquarters was aghast

er, a tiny two-seater, looked like a toy and was too small to be practical, even by the standards of that era. The company badly misjudged the market, he says. As if handling an ancient, sacred parchment, Schloch pulls out a yellowed, typewritten 1959 plan for turning the company around with a new class of sporty sedans. Schloch then hands out photos of Herbert Quandt and the labor leader of the period, Kurt Golda. "I explain how we rebuilt the company with Quandt's money and the power of the workforce," says Schloch. "And I tell them that's the way it works today, too."

## Happy Workers, Better Cars

BMW DERIVES MUCH OF ITS STRENGTH from an almost unparalleled labor harmony rooted in that long-ago pact. In 1972, years before the rest of Europe Inc. began to think about pay for performance, the company cut workers in on its profits. It set up a plan that distributes as much as one and a half months' extra pay at the end of the year, provided BMW meets financial targets. In return, the workforce is hyperflexible. When a plant is introducing new technology or needs a volume boost, it's not uncommon for workers from other BMW factories to move into temporary housing far from home for months and put in long hours on the line. Union bosses have made it easy for BMW to quickly adjust output to meet demand. Without paying overtime, the company can crank up production to as much as 140 hours a week or scale it back to as little as 60 hours. The system lets the company provide unprecedented job security, and no one at BMW can remember any layoffs—ever. Since 2000, BMW has hired 12,000 new workers even as General Motors Corp. and Ford Motor Co. have slashed tens of thousands of jobs.

That helps explain why landing a job at BMW is to many Germans what getting into Harvard is for American high school students. The company's human resources department receives more than 200,000 applications annually. Those who make an interview undergo elaborate day-long drills in teams to screen out big egos. For the lucky few who are hired, a 10-day probationary test of survival ensues. BMW promotes talented managers rapidly and provides little training along the way, forcing them to reach out to others to learn the ropes. With no one to coach them in a new job, managers are forced to stay humble and work closely with subordinates and their peers, minimizing traditional corporate turf battles. Anyone who wants to push an innovative new idea learns the key to success fast. "You can go into fighting mode or you can ask permission and get everyone to support you," says Stefan Krause, BMW's 44-year-old chief financial officer. "If you do it without building ties, you will be blocked."

That BMW's spectacular Leipzig factory was ever built is testament to the power of such ties. When plant manager Claussen first proposed a competition to lure top architectural headquarters was aghast. "People said to me, 'What's wrong with these guys in Leipzig?'" recalls Krause. "We don't need beautiful buildings, we need productive buildings." Claussen convinced Krause and others that the unconventional approach wouldn't just produce a pretty factory but whose open, airy spaces would improve communications between line workers and managers and create an environment that helps the company build cars better.

Even before Claussen began pushing his architectural vision, others were busy designing the inner workings of the plant. Newly minted engineer Jan Knau was only 27 in 2000 when he was asked to come up with a flexible assembly line for the factory. Knau, then just a junior associate, rang up BMW's top assembly engineers, inviting them to a two-day workshop at a BMW retreat near the Austrian Alps. The calls paid off. After a series of marathon sessions that included discussions of every facet of the ideal assembly line, Knau sketched a design with four "fingers," or branches, off the main spine. The branches could extend to add equipment needed to build new models.



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## A Role Model for The Team Player

**I**n his 19-year career at BMW, Norbert Reithofer has worked his way up from maintenance planner to head of production and finally, on Sept. 1, to chief executive. A quintessential BMW man, Reithofer led the company's drive for greater factory flexibility and customization, helping to give the automaker its competitive edge.

Like every successful BMW manager, Reithofer has learned how to build informal networks of associates across the company to make sure his ideas are embraced. And he definitely has a gold-plated network. When Reithofer ran BMW's factory in Spartanburg, S.C., the U.S. chief was Helmut Panke,

who was later promoted to CEO. And Reithofer's thesis adviser in graduate school was Joachim Milberg, Panke's predecessor as CEO and now chief of BMW's supervisory board.

But that's not the kind of network that really matters at BMW. While it never hurts to have friends in high places, 50-year-old Reithofer has excelled at forging alliances at all levels. Back in 2002, for instance, he and Development Chief Burkhard Goeschel wanted to halve the time it took to reach full production of the next-generation 3 Series, to three months from six. That would slash startup costs and boost margins by allowing the company to pump more cars onto the

**FLEXIBLE** Output of the 3 Series was ramped up fast—without hurting quality

market while interest in the new model was still superhot.

Skeptics said it couldn't be done without compromise

quality. But Reithofer and Goeschel reached deep into the organization to assemble a team of R&D and production aces who worked for three years to reach their target. The car was introduced in May and by June the factory was cranking out full-scale production of 800 cars a day—with no quality problems. "[Managers]

have to be role models and work together," says Reithofer.

As CEO, he will surely seek to keep BMW's management and factory hands working together to stay ahead of the pack. And Reithofer seems to believe the pack will be coming at him from the east. One BMW staffer who has worked with the new chief says he "never spoke



**CEO REITHOFER**  
Watching Lexus

about Mercedes. He was always looking over his shoulder at Toyota."

Over the next decade, BMW expects Toyota Motor Co.'s Lexus and Nissan Motor Co.'s Infiniti brands to set up plants in Europe and then hire German engineers to work on building cars with BMW-like handling. Within five years, predicts Reithofer, it could be "Lexus that we will most busy competing with."

—Gail Edmond

making it possible to keep giant robots along the main line in place rather than moving them for each production change, an expensive and time-consuming process.

Leipzig opened in May, 2005, joining Claussen's vision of teamwork enhanced through design to Knau's smart engineering concepts. With pillars of sunlight streaming through soaring glass walls, architect Hadid's design looks more like an art museum than a car factory. Open workspaces cascade over two floors like a waterfall. Unfinished car bodies move along a track, bathed in ethereal blue light, that runs above offices and a smart-looking, open cafeteria. If the parade of half-finished cars slows, engineers feel the pulse of the plant change and can quickly investigate the problem. And weekly quality audits—in a plaza workers pass on their way to lunch—ensure that everyone is quickly aware of any production snafus. The combination of togetherness and openness sparks impromptu encounters

among line workers, logistics engineers, and quality experts. "They meet simply because their paths cross naturally," Knau. "And they say, 'Ah, glad I ran into you, I have an idea.'"

The flexibility of BMW's factories allows for a dizzy choice of variations on basic models. At Leipzig, for instance, parts ranging from dashboards and seats to axles and wheels snake onto overhead conveyor belts to be lowered into the assembly line in precise sequence according to customers' orders. BMW buyers can select everything from engine type to the color of the gear-shift box to a seemingly endless number of interior trims—and then change their minds and order a completely different configuration as little as 10 days before production begins. Customers love it. They receive some 170,000 changes a month in their orders, mostly high-priced options such as a bigger engine or a more luxurious interior. There are so many choices that line workers assem-



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## FAST MOVER

### Mini Cooper

BMW's premium small car debuted in 2001 and has been a hit ever since. Mini prices start at \$17,450, but the average buyer spends nearly \$28,000 with options.

exactly the same car only about once every nine months.

That kind of individualization would swamp most automakers with budget-busting complexity. But BMW has emerged as a sort of anti-Toyota. One excels in simplifying automaking. The other excels in mastering complexity and tailoring cars to customers' tastes. That's what differentiates BMW from Lexus and the rest of the premium pack. "BMW drivers never change to other brands," says Yoichi Tomihara, president of Toyota Deutschland, who concedes that Toyota lags behind BMW in the sort of customization that creates emotional appeal.

Bottom-up ideas help keep BMW's new models fresh and edgy year after year. Young designers in various company studios from Munich headquarters to DesignWorks in Los Angeles are constantly pitted against one another in heated competitions. Unlike many car companies, where a design chief dictates a car's outlines to his staff, BMW designers are given only a rough goal but are otherwise free to come up with their best concepts.

To get the most out of its people, BMW likes to throw together designers, engineers, and marketing experts to work intensively on a single project. The re-design of the Rolls-Royce Phantom, for instance, was dubbed "The Bank" since the 10 team members worked out of an old bank building at London's Marble Arch, where dozens of Rolls roll by daily. "We took designers from California and Munich and put them in a new environment" to immerse them in the Rolls Royce culture, says Ian Cameron, Rolls's chief designer. The result was the 2003 Phantom, a 19-foot edifice on wheels

### DETAILS, DETAILS

Designers work on a clay model at BMW's DesignWorks in Los Angeles



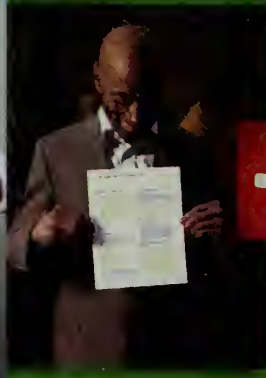
that remains true to Rolls's DNA but with 21st century lines. BMW's technological muscle under the hood. With sales of \$350,000 car running at about 700 a year, the Phantom is best-seller in the superluxury segment, outstripping both Bentley Arnage and the Mercedes Maybach.

Much of BMW's innovation, though, doesn't come via formal programs such as The Bank. In 2001 management decided to pull the plug on the disappointing Z3 sports coupe. But it didn't stop a 33-year-old designer named Sebastian Trübs from doodling a sketch of what a Z3 successor might look like. Ulrich Bruhnke, head of BMW's high-performance division, loved it. In Trübs's drawing, Bruhnke saw a car that could rival Porsche's Cayman S in performance but at a lower price. He persuaded a few designers and engineers to carve out some time for the renegade project. Next, Bruhnke gathered a team to map out the business case. The small group toiled for months to build a prototype.

The moment of truth came in November, 2004, at a secret test track near Munich. Cars were lined up so the board could examine their styling proportions in natural light. Only one was covered by a sheet. Panke approached the mysterious model. "What is this interesting silhouette?" he asked Bruhnke, who invited his boss to take a look. Panke yanked back the cloth, exposing a glittering bronze metallic prototype of what would become the Z4 coupe. Bruhnke breathed a sigh of relief when he saw Panke's eyes light up as they swept over the car's curved surfaces. Panke and the board quickly gave the go ahead, and the Z4 moved to production in just a few months, hitting showrooms in summer. Bingo. BMW's factory wins again. ■



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**STAR POWER** Barack Obama puts in an appearance for Democratic candidate Bruce Braley at a Davenport rally

Over eggs and made-in-Iowa con and sausage, Flo Spivey, vice-president for hospital operations at Trinity Medical Center in Bettendorf, told the candidate that 8 of the district's 12 counties have no OB/GYN doctors because of malpractice insurance costs. "We need tort reform," she said.

Whalen, whose support in business helped him to place over two more socially conservative candidates in a wide June primary, is hoping to capitalize on the name recognition of his quarter-century in the restaurant and hotel business. But

his staunchest supporters are worried that the scandal that broke in Washington on Sept. 30 involving sexually explicit e-mails sent to a teenage male page 1 Representative Mark Foley (R-Fla.) will make a challenging political environment even more harrowing.

#### PULLING OUT ALL THE STOPS

IF WHALEN LOSES, it won't be for lack of resources. Business accounts for 60 percent of Whalen's campaign contributions, according to the nonpartisan Center for Responsive Politics. The Iowa Association of Business & Industry is helping educate workers about the differences between the candidates and early-voting procedures. Deere & Co., the district's largest employer, has created a customized election Web site. "People have figured out what's good for business is good for jobs," says Kendig Kneen, chief executive officer of Al-Jon Inc., an Ottumwa (Iowa) maker of car-crushing devices.

Not surprisingly, the district has flooded with proxies for both candidates. Whalen has imported Republican heavyweights such as First Lady Laura I

## Swing State Showdown

Why business, organized labor, and lawyers are fixated on a congressional race in Iowa

BY RICHARD S. DUNHAM

**F**ROM ITS ROLLING CORNFIELDS to the small manufacturing operations on the bluffs above the Mississippi River, the first congressional district of eastern Iowa has become a leading battleground in the Republican effort to fend off an increasingly plausible Democratic takeover of Congress. Business interests have made the race a top priority, and for good reason: It is a swing district in a swing state, featuring two articulate and well-funded candidates vying to replace departing Republican Representative Jim Nussle. The U.S. Chamber of Commerce and other business groups have poured money into the campaign of the Republican candidate, restaurateur Mike Whalen, who argues on the stump that he knows firsthand about the impact of taxes, regulation, and government mandates on the private sector. Organized labor and lawyers, meanwhile, have fueled the campaign of Democratic candidate Bruce Braley, a plaintiff's attorney and a former

president of the Iowa Trial Lawyers Assn.

"From a business perspective, you have a race that ought to interest everyone very much," says John R. Gilliland, senior vice-president at the Iowa Association of Business & Industry.

Whalen has played the business card early and often. On Sept. 28, he took part in a roundtable at a riverside hotel in the town of Bettendorf with women executives who lamented the costs of lawsuits to business and praised Whalen's understanding of the burden of regulation.

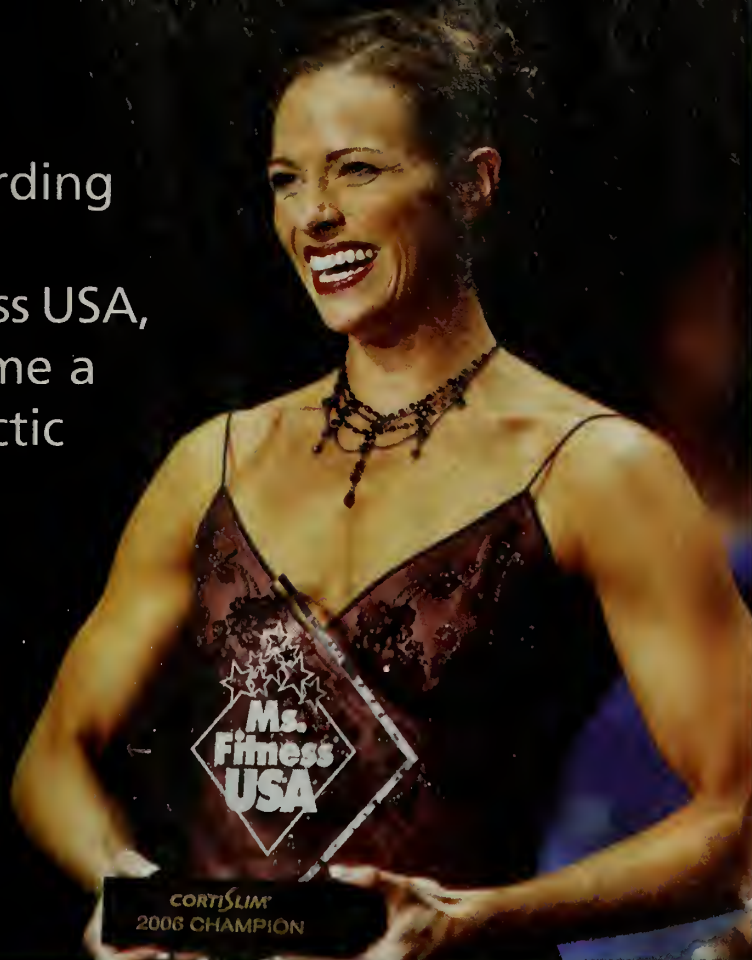
### The Election at a Glance

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|---------------------------------------------------|-----------------------------|-----------------------------|----------------------------------------------------|-----------------------------|-----------------------------|
| 15                                                | 33                          | 7                           | 6                                                  | 8                           | 3                           |
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## Sarah's Secret

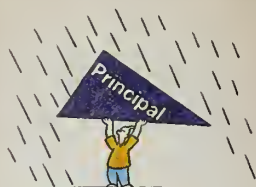
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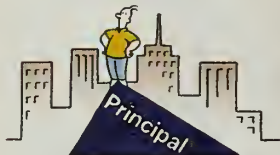


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Vice-President Dick Cheney, White House political guru Karl Rove, and Senator John McCain (R-Ariz.). Braley has countered with Democratic star Senator Barack Obama of Illinois, 2004 Vice-Presidential nominee John Edwards, and 2008 Presidential hopeful Mark Warner, former governor of Virginia. Labor has hundreds of ground troops here, and lawyers have donated more than \$460,000 to Braley.

Normally, a well-financed Republican like Whalen might have an edge in a district that has not elected a Democrat to Congress since 1974. But this is not a normal year. A recent poll found that President Bush's job approval rating in the district has dropped to 30%, and the Iraq war is very unpopular in a state suffering

and a fence along the Mexican border get tired of business having the finger pointed at us, that somehow we are scrofflaws or criminals," Whalen says. "This is a government problem. This is not a business problem."

Whalen's platform mirrors that of the business establishment. He calls for an overhaul of the tax system and creation of private savings accounts within the Social Security system. He favors immediate deductibility of capital equipment and advocates limits on medical malpractice suits. "The reason I ran is to get things done," he says. "I don't need a majority and I don't need to be in Congress to get things done."

But Democrats think Whalen's business successes can be turned into



TOP GUN McCain turns up at a rally for Republican Mike Whalen

a disproportionate number of casualties.

Democrats must pick up 15 GOP seats to take back the House, and this district is one of the most vulnerable of the three dozen currently in play. Independent polls vary widely, and the e-mail scandal that has rocked the Republican House leadership will only complicate matters. "This is a very tough race," McCain says.

The GOP nominee is well-known for his chain of Iowa restaurants, The Machine Shed, featuring vintage farm implements, rustic decor, homegrown Iowa pork dishes, and Aunt Grace's famous apple dumplings. "He's not elite or upper crust," says Delia Meier, who owns and operates the largest truck stop in Iowa. "You cannot work in a restaurant and not be one of us."

Whalen is not your typical partisan. Like many executives, he decries fiscal mismanagement on the GOP's watch. He defended companies' attempts to deal with illegal immigration while his primary opponents called for deportations

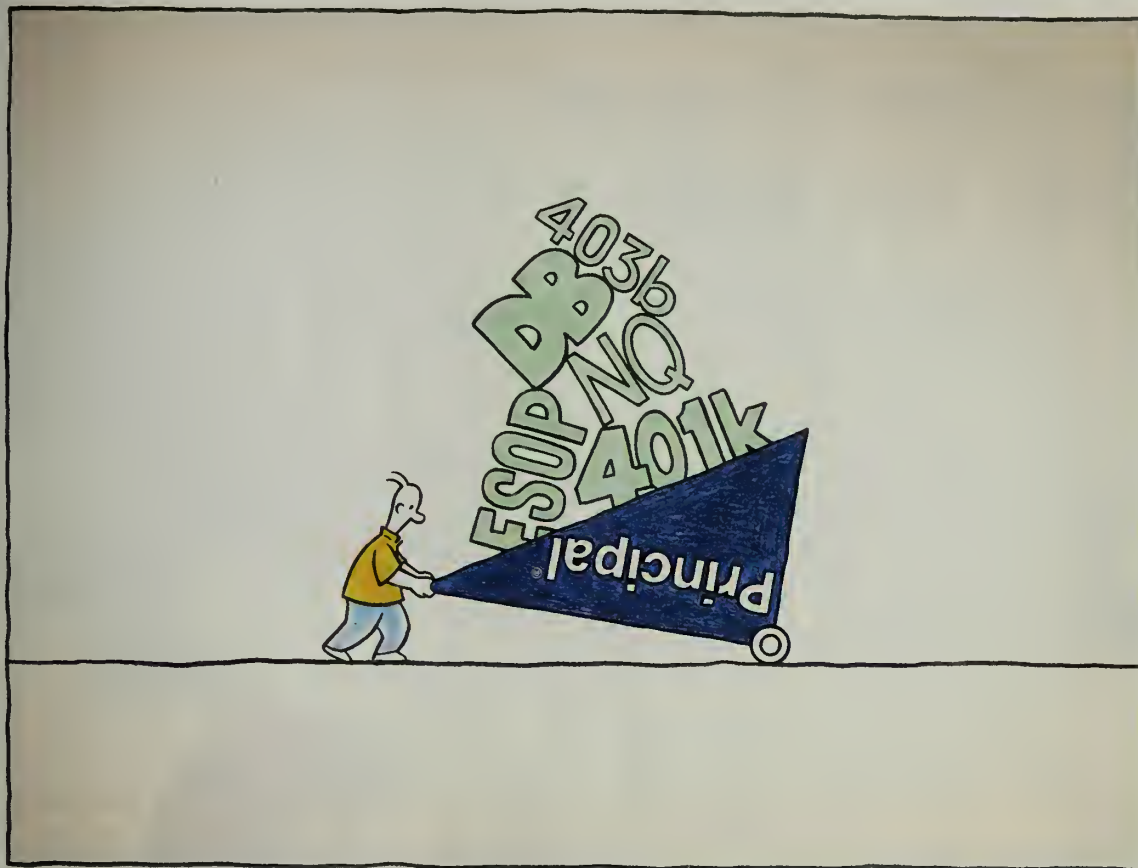
## Dems are positioning Whalen's business-friendliness as a liability

Achilles' heel. TV ads by "Millionaire Mike" for privatizing some of his restaurant employees' paltry wages and for moving his corporate headquarters to Illinois to avoid Iowa taxes. "I got a good restaurant, he's made his money on the backs of a lot of people who make the minimum wage," says Mike Taylor, president of the American I

eration of State, County & Municipal Employees unit in Davenport.

Braley also accuses Whalen of trying to privatize Social Security to aid rich V Street buddies. "His politics of privilege benefit the richest 1% of people in the country," he roared at a Sept. 30 rally in Davenport with Obama.

Braley's platform combines anti-rhetoric with fiery economic populism. He advocates an increase in the minimum wage, expansion of renewable fuels, and a new approach to trade. "I know what it's like to work a minimum-wage job," says Braley, who worked throughout college and law school. "My opponent has never applied for a job as an adult." ■



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# One More Reason Prices Are Falling

Floating oil factories allow tankers to load at sea, avoiding political instability and saving billions

BY CHRISTOPHER PALMERI

**N**IGERIA IS A ROUGH place to do business. In the past year, rebels seeking a greater share of the country's energy wealth have bombed Royal Dutch Shell's pipelines and kidnapped its workers. The oil giant was forced to shut down half of its production there, most of which is situated in the Niger River Delta, a steamy swamp-land populated by farmers, fishermen, and angry militias.

and can hold up to 2 million barrels in its belly, but its primary purpose is to load up tankers out at sea, rather than piping the crude to an onshore terminal. The oil streaming in from Bonga and other deepwater sites like it helps explain why oil prices have settled down to under \$60 from a July high of \$78.

For the oil companies, benefits abound. FPSOs spare them billions of dollars in infrastructure costs, years of construction time,

barrels per day, up from 1.5 millionrels five years ago, according to oil industry researcher Wood Mackenzie.

Handling millions of barrels of oil far out at sea does open up the risk of spills and other types of contamination. But that's not likely to slow the proliferation of FPSOs. As more production moved farther offshore in the past years, the number of these immense vessels in uses has doubled to 113 worldwide, according to industry consultant Douglas Westwood Ltd. An additional 83 will be launched by 2011, worth an anticipated \$26 billion in revenues to shipbuilders, most of them based in Korea and Japan.

Costing hundreds of millions of dollars apiece and measuring as much as two football fields in length, the platforms are towed from the manufacturer's shipyard and anchored at the richest oil fields at sea, they're typically tended by some 100 crewmen who work a month on, a month off. "We call them superboats," says Michael Flynn, head of deepwater developments for ExxonMobil Corp. "They're really like small cities."

ExxonMobil sometimes selects smaller FPSOs to jump-start production at fields with serious infrastructure problems. Under a program it calls "design one, build three," the company has ordered up three FPSOs for use at a series of fields in West Africa. It cost \$10 billion to bring the fields online, but they produce combined 700,000 barrels per day, nearly 1% of worldwide oil demand.

The one part of the world where floating factories have yet to make appearance is the Gulf of Mexico, where there is already an extensive pipeline infrastructure. But things may change with a big discovery in the deepwater in late summer with Chevron Corp. looking at FPSOs.

What about hurricanes? FPSOs operated by Conoco-Phillips off the coast of China and Vietnam are designed to turn in place, minimizing the impact of waves during typhoon season. They can also detach from the undersea wells and get towed away if conditions turn ominous. Built that way, facilities in the Gulf could endure weather better than the ones dependent on the pipelines that were battered so severely by hurricanes last year. ■

**PUMPING** The vessels help ExxonMobil produce 700,000 barrels per day off West Africa's coast

Far out at sea, the situation is much safer. Since late last year, Shell has been extracting oil from its massive Bonga field, a \$3.6 billion project located in 3,200 feet of water. The field now yields more than 200,000 barrels a day, thanks to a high-tech facility called a floating production, storage, and offloading vessel, or FPSO. It looks like an oil tanker

and in the case of Nigeria, the significant costs and setbacks associated with political instability. "The FPSO gives you a great deal of flexibility," says John Stubbs, the Shell executive who got the Bonga project up and running.

FPSOs are now pumping away off the coasts of Brazil, West Africa, and Southeast Asia, extracting more than 5 million





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Discuss with your doctor first. Make sure you are healthy enough to have sex. If you have chest pain, nausea, or other discomforts during sex, stop taking VIAGRA and seek immediate medical help right away.

Although erections lasting for more than four hours may occur rarely with all ED treatments in this drug class, to avoid long-term injuries, it is important to seek immediate medical help.

In some instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision. It is not possible to determine whether these events are related directly to these medicines or to other factors. If you experience sudden vision loss or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

Most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less common are bluish or blurred vision, or being sensitive to light. These may occur for a brief time. Remember to protect yourself and your partner from sexually transmitted diseases.

See your patient summary of information for VIAGRA (25 mg, 50 mg, 100 mg) tablets on the following page.

VIAGRA is available on most Managed Care Plans.\* VIAGRA is one of several ED treatments that you and your doctor can consider.

\*Coverage of members by formulary status for HMOs, PPOs and POS for Viagra. Formulary Compass™ MediMedia USA, Inc. May 2006.

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# VIAGRA®

(sildenafil citrate) tablets

This summary contains important information about VIAGRA®. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA.

This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.

## • What Is VIAGRA?

VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

## • How Sex Affects the Body

When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

## • How VIAGRA Works

VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

## • VIAGRA Is Not for Everyone

As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- Nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- Isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

## • What VIAGRA Does Not Do

- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV—the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

## • What To Tell Your Doctor Before You Begin VIAGRA

Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- Have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- Have ever had a stroke
- Have low or high blood pressure
- Have ever had severe vision loss
- Have a rare inherited eye disease called retinitis pigmentosa
- Have ever had any kidney problems
- Have ever had any liver problems
- Have ever had any blood problems, including sickle cell anemia or leukemia
- Are allergic to sildenafil or any of the other ingredients of VIAGRA tablets

- Have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- Have stomach ulcers or any types of bleeding problems
- Are taking any other medicines

## • VIAGRA and Other Medicines

Some medicines can change the way VIAGRA works. Tell your doctor about any medicines you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking medicines called alpha-blockers for the treatment of high blood pressure or prostate problems, your blood pressure could suddenly drop. You could get dizzy or faint.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

## • Finding the Right Dose for You

VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

Your doctor may prescribe a lower dose of VIAGRA in certain circumstances. For example:

- If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA.
- If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period.
- If you have prostate problems or high blood pressure for which you take medicines called alpha-blockers, your doctor may start you on a lower dose of VIAGRA.

## • How To Take VIAGRA

Take VIAGRA about 1 hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

## • Possible Side Effects

Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision in one or both eyes. It is not possible to determine whether these events are related directly to these medicines, to other factors such as high blood pressure or diabetes, or to a combination of these. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

## • Accidental Overdose

In case of accidental overdose, call your doctor right away.

## • Storing VIAGRA

Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

## • For More Information on VIAGRA

VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit [www.viagra.com](http://www.viagra.com), or call 1-888-4VIAGRA.

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June 2006



**BEST DEFENSE** "You have to shake things up" to stay relevant, says Francesconi

# March of the Lunar Penguins

Raytheon, Louise Francesconi's teams think way beyond missiles

SUSAN BERFIELD

**D** IN THE MORNING OF Sept. 1, Louise L. Francesconi sat anxiously with colleagues in Tucson, receiving regular updates about a test of the government's ballistic missile defense system. As head of Raytheon Missile Systems, a position she has held for a decade, she was monitoring the progress of what's called the kill vehicle, which her company had developed for Raytheon Co. A little after 10:30 she got word the refrigerator-size weapon, moving at 10,000 mph, had destroyed a mock warhead 100 miles above the Pacific Ocean. She issued a public statement that afternoon: "This highly successful test... clearly demonstrates the maturity of our technology and our ability to provide this

critical capability to the nation." Then she turned to the other part of her job: trying to lessen the dependence of her \$4.1 billion company and 11,000 employees on legacy programs such as this one, which began 23 years ago.

Francesconi, the highest-ranking woman in the defense industry, worked her way up in the company only to find, once in charge, that she needed to disrupt the entire ecosystem. Raytheon is used to success on its own terms. She hopes to coax it into becoming more responsive to its customers, whoever they might be, and more creative when thinking about the future. "It can be a very orthodox business," she says. "You have to shake things up."

Francesconi, now 53, grew up in the business—her father was an engineer at Hughes Aircraft Co.—but her early

ambitions had nothing to do with that world. She came of age in Santa Monica, Calif., in the 1960s, the middle of three children. She suffered from mild, undiagnosed dyslexia, played the guitar, wrote children's songs, and thought she would be an elementary school teacher. Then a summer job helping a neighbor set up a music company "turned me on to being in the business world," she says. Later, at Scripps College, in Claremont, Calif., she studied economics. She ended up at Hughes one summer, trying to hedge company contracts against inflation. After graduating in 1975, she got a full-time position in the finance department.

Francesconi was young and impatient, but she had no technical expertise. The company was dominated by male engineers; its pace was deliberate. She turned to her father, who worked at Hughes for



four decades before retiring, for help sorting out the politics. "There was more than one day when I told him: 'This is the day that I'm quitting,'" she recalls. "He inspired me to change the organization instead of letting it change me."

So she stayed, earning her MBA at the University of California at Los Angeles while continuing to work. By the time General Motors Corp. bought Hughes in the mid-1980s, Francesconi was a manager in the finance department and deeply involved in preparing Hughes for life as a public company. It was then that she got to know Barb Keeler, who worked in Hughes's finance department in Tucson. Keeler retired in 1996, and the two remain friends. When asked to describe the working environment for women, Keeler chooses her words carefully. "You had to recognize that to be in management would mean you'd be in a room full of men most of the time," she says. "You don't ask people to act differently because you're a woman. It had to be a nonissue."

## TURN UP THE MUSIC

THE TURNING POINT in Francesconi's career came with Hughes's acquisition of General Dynamics Corp.'s missile business in 1992. "I was in the finance department, but ultimately I became the central coordinator for all issues," she says. "I became a CFO out of that experience." Keeler says that Francesconi's decisiveness impressed the old-timers.

The promotion meant moving her family from the San Fernando Valley to Arizona, an unhappy consequence of success, as far as her husband was concerned. It also led to their decision that he would retire from Hughes, where he was the director of quality, to stay home with their young son.

The arrangement is unusual enough that Francesconi's friends are intent on dispelling the image it might conjure up of her as a woman concerned only with work. They invariably describe her as more than happy not to talk about her job, and quite willing to go on boating and camping trips where she can't easily be reached. Jan Hastreiter, a Tucson real estate agent who has sold houses to Francesconi and other Raytheon executives, says: "Louise is fun. She likes to turn up the music and dance in the kitchen while she cooks. You would never know what kind of a job she has, in terms of responsibility, when you first meet her."

In 1996, three years after becoming CFO, Francesconi was named president of Hughes Missile Systems Co., the first woman, youngest executive, and only non-

engineer to run a major business at the company. Being a woman was not her only problem. "To be honest," she says, "all those differences mattered." She regards dwelling on them, though, a total waste of time. When Raytheon bought Hughes a year later, she was put in charge of its missile division, which accounts for some 20% of Raytheon's sales.

About five years into the job, in the wake of integrating the businesses, September 11, and the advent of the high-tech battlefield, Francesconi started to worry that if the company didn't change, "we would become the buggy whips of the industry." One thing most colleagues

But I don't want them to feel obs Then I have a group of futurists. I tell their job is to make the others feel obs I foster a creative tension." She de 40% of her discretionary investment to these programs and technologies.

Sales at Raytheon Missile System up 17% since 2003, but it's not bec the company has succeeded with thing totally out of character. "Have done a lot yet? No, but they're tr They're imaginative," says Heidi V a Morgan Stanley analyst.

The "Lunar Penguin," just a proj for now, is an intriguing example of theon's ambitions. NASA, which is

ing for water on the n needs a probe that ca to precise locations w hydrogen has been de ed. Michael W. Booen, tired Air Force colone "the guy who pushes new markets" at Raytl sent engineers to talk NASA's engineers a the problems they encountering. Event Raytheon came up a lunar lander the si a small coffee

## INNOVATOR

# Louise L. Francesconi

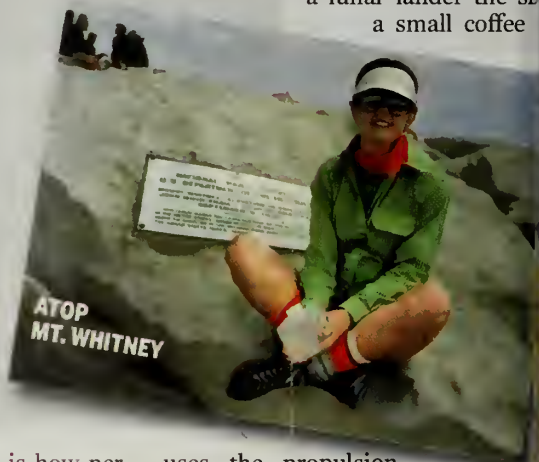
**WHAT I LOOK FORWARD TO EVERY DAY** Learning something new—anything

**GREATEST INDULGENCE** Red wine and Maui Style potato chips

**WHAT I DREAD** Not having enough time at the end of the day for just me

**PEAK EXPERIENCE** Climbing California's Mt. Whitney (photo) with my fiancé a month before our wedding

**MOST EMBARRASSING MOMENT** Going into labor with my youngest son while making a presentation to the president of the company



mention about Francesconi is how persuasive she can be. As she puts it: "My job is to make people see how they fit into the future." She can also be blunt. "She always emphasizes that we have to think differently or the business will die," says Kevin Peppe, a retired submarine captain who joined Raytheon in 2003.

Francesconi created what she calls an innovation tank: two groups of about 650 people focused on developing new technologies for use on and off the battlefield. She also set up a Bike Shop where engineers and machinists quickly develop prototypes of weapons altered to the changing demands of urban warfare. She describes her approach this way: "I want to co-opt the group that maintains the wheel.

uses the propulsion system, guidance electronics, and so ware from its Tomahawk missiles.

The rest of her employees, Frances hopes, are learning from that kind of thinking. "Does the main organization look at the innovation group with dis sometimes? Sure. If I didn't write check, they'd be starved," she says.

When describing how she overcoo lingering resistance, Francesconi about being a mother. "You go h frustrated and tired. Your kids are g in one direction, and you want to g the other," she says. "The same kin skills are required in the workplace all about getting people to move in same direction." ■



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## Enough With the Shoot-'Em-Ups

Skunk's Margaret Wallace develops 'casual games.' Turns out the market for them is huge

BY REENA JANA

**M**ARGARET WALLACE, CEO of video game developer Skunk Studios, represents the kinder, gentler face of her industry. With her vivid dyed hair and hip wardrobe, Wallace looks anything but the typical corporate CEO. That's no accident: Skunk's four male co-founders chose her to be in charge in part because Wallace, 39, represented the demographic that they were trying to reach. Her company's so-called casual games, with their simple graphics and short learning curves, are more akin to early *PacMan* than to today's violent, complex shoot-'em-ups. "For so long, developers and designers focused only on one segment of players," says Wallace. "It's as if Hollywood only made action movies. It's fun to make video games for the rest of us."

So while *Grand Theft Auto* and other celebrations of bad behavior make headlines, Skunk's 15 employees turn out

titles based on pastimes such as tennis and mah-jong. Skunk's most popular title is *Gutterball 2*, a cartoony bowling game with alleys set in the Arctic and in jungles. At about \$20 a pop, it's been downloaded 128,000 times from the Skunk site alone.

In September, gaming news Web site Next Generation listed Wallace as one of the most influential women in video games—proof that the \$10.5 billion industry has taken notice of the \$2 million company. "Having a woman in charge can help make sure there's a more diverse group of people making games for newer audiences," says Eric Zimmerman, CEO of gameLab, another casual-game developer.

Developing casual online titles can be much less risky than trying to create a game that runs on a console such as an Xbox. Casual games typically cost less than \$200,000 to produce, and production cycles are only six months to a year. There's no shelf space, packaging, or CD production to pay for. Best, says Wallace, "there's more room for innovation."

**WALLACE** Her type of game is cheaper to produce and gets to market quicker

Wallace hardly new to casual games. In the late 1990s, the digital design

she worked with artists Jason Calde and Thomas Estess and programmer Kalle Wik and Joseph Walters at Skunkwave.com, an online game developer. The quintet shared a vision of writing games for families. The key would be to produce titles that weren't violent and didn't require an expensive console. They got their chance in 1999, when all were laid off.

### NO BOYS' CLUB

SKUNK HAS made good on its goal of reaching out to a different demographic. Some 60% to 70% of players of Skunk games are women in their 30s and 40s, Wallace and her co-founders are in the industry sweet spot: The average age of frequent purchasers of all computer games is now 40, and women gamers over 18 far outnumber boy gamers at 17, according to the Entertainment Weekly Assn.

Grabbing and maintaining that market has required some savvy moves. When Skunk started, it was one of the smallest, independent casual-game makers. Now it's facing competition both from the industry giants—Electronic Arts, Microsoft, Yahoo!—and growing independents, such as PopCap Games and Sandlot Studios. To boost visibility, Skunk partnered with RealNetworks in 2004, allowing Skunk to offer casual games from other developers on its site. The goal was to turn Skunk into a hub for casual gamers and increase awareness of its titles. The strategy has boosted downloads of Skunk titles by 565%.

Then there's the matter of protecting Skunk's intellectual property—an especially formidable challenge in the game industry, where competitors often rip off one another's characters and plot lines with bigger marketing budgets. Skunk simply riffed on a popular concept, Skunk's Arctic bowling. Wallace says she sent out a simple e-mail. If that didn't work, she calls the offender herself. "I try to reach out warmly," she says, "because these game developers might one day be my colleagues." If all else fails, it's time for a cease-and-desist letter. Every now and then, even the kinder face of video games needs to call in the big guns. ■

**BusinessWeek online** For a look at Skunk's casual games, visit [businessweek.com/smallbiz](http://businessweek.com/smallbiz)

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AM ASTON

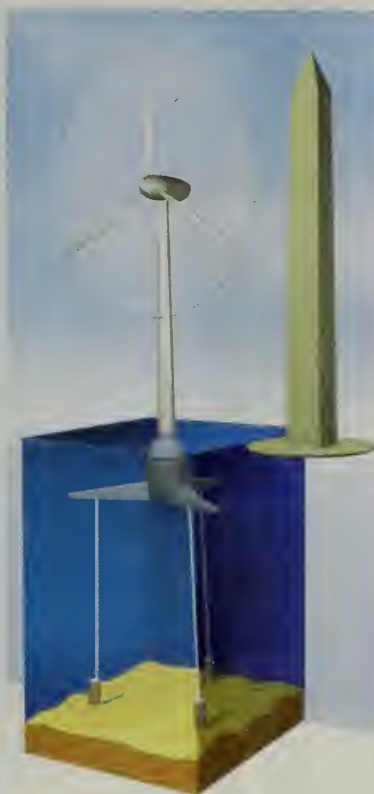
## SAFETY FIRST FIRE ALARM FOR LAPTOPS

**THE NUMBER** of batteries killed by PC makers has risen into the millions, and a team of South Korean scientists has unveiled a way to prevent them from going up. Scientists at the state-funded Korea Electronics & Communications Research Institute (ETRI) created a programmable sensor that helps prevent overheating in lithium-batteries, the culprits in a number of recent fiery explosions. Once battery voltage hits a preset limit, the team's sensor starts to discharge electric current, reducing the chance of heat-induced swelling.



Although the ETRI team has done tests only on mobile phone batteries, the device should also work for PCs, MP3 players, and other gadgets, says Hyun Tak, the team's principal researcher. Hybrid cars could benefit, too. Such vehicles currently run on nickel-metal hydride batteries, but manufacturers are expected to switch to lighter, higher lithium-ion cells. ETRI says it could take up to three years to bring the device to market.

— Moon Ihlwan



## ALTERNATIVE ENERGY DEEPWATER WINDMILLS OF A DIFFERENT STRIPE

**WINDMILLS MOORED SO FAR** offshore that they aren't visible from land would do more than silence most "not in my backyard" critics. Gigantic deepwater turbines could also crank out much more juice than current models. But current sea-sited windmills can't go past depths of about 45 feet. In deeper water, it gets too costly to drive into the seabed the hollow "monopiles" that support today's windmills.

Using tricks borrowed from the oil biz, Massachusetts Institute of Technology professor Paul D. Sclavounos proposes joining the wind turbine to a floating base secured to the sea floor by tense metal cables. This saves on building materials. Plus, the platform and windmill can be assembled in dry dock, then towed to a mooring site, eliminating the need for specialized crane ships and costly labor used to hoist offshore windmills into place today. Sclavounos' design promises to be economically viable in waters as deep as 600 feet. At 20 miles from shore, the floating turbines would not be seen from land, and steady winds would justify the use of supersize 5-megawatt models as tall as the Washington Monument.

## CAMERAS TINY MIRRORS, AND JUST ONE PIXEL

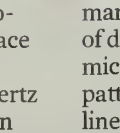
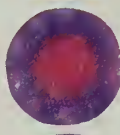
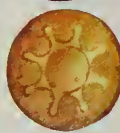
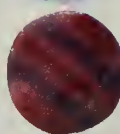
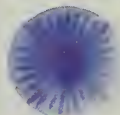
**TODAY'S DIGITAL CAMERAS** capture the world as millions of points of light (megapixels) and use millions of light sensors to record the amount and color of each one. Then a chip crunches the data into an image you can e-mail to friends. All that processing takes lots of power, which is why cameras eat up batteries.

Rice University electrical engineering professors Richard G. Baraniuk and Kevin F. Kelly are building a different kind of camera that relies on just one pixel. They use an array of millions of microscopic mirrors that flip randomly on and off. This digital micromirror, already found in some rear-projection TVs, sends a random combination of pixel values to a single photo sensor. For the

same size image, the method produces fewer measurements than pixels and there is a smaller amount of data, so the information can be transmitted more easily. The approach is "useful for a network of cheap sensors," says Baraniuk. The work is being funded by the U.S. Defense Advanced Research Projects Agency and Texas Instruments.

This method also opens the door to cameras that can "see" in the terahertz region, part of the electromagnetic spectrum between microwaves and infrared, a place that megapixel sensors usually can't go. A terahertz camera "would be a boon for homeland security, because it can see through clothes and luggage," says Baraniuk.

— John Carey



## MICROTAGS TRACE YOUR SPINACH

**SEPTEMBER'S SPINACH** scare was linked to farms in three California counties. But since there was no way to know where the spinach in any given bag originated, supermarkets had to trash every one.

ARmark Authentication Technologies, a unit of Adhesives Research in Glen Rock, Pa., hopes to solve the problem by using digestible

markers tinier than specks of dust. Each microtag, mere microns wide, can hold a pattern (above) or up to 16 lines of text. Readable with a handheld device, the tags can be put in water and sprayed on. A head of spinach might hold up to 1,000 of the dots.

— Cathy Arnst



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# Why Wait Till The Paint is Dry?

Auction house Phillips de Pury's focus on ultracontemporary art is starting to pay off

BY MOIRA HERBST

IT'S EARLY EVENING IN Manhattan's Chelsea gallery district, and a cluster of young professionals cuts a sharp image against the white walls inside a converted warehouse. Beside them, a row of beautiful people sit before a row of paintings. Simon de Pury presides over the room, beads of sweat forming on his forehead. "All right, chance then," Simon de Pury calls out in his French accent, closing the deal on *Huggable Atomic Mushroom*, a one-high, white pillow shaped like a nuclear explosion. "Sold! For \$20,000 only," he proclaims with a knock of the gavel, getting rebuking the crowd for parsimony.

The chairman of Phillips de Pury & Co., he is sometimes called the Mick Jagger of the auction world. Where rivals Christie's International and Sotheby's project an image of elite, traditional, Anglophilic good taste, de Pury strives for the youthful, edgy and controversial. Where the two major houses consist mostly of art produced over the past few years unproven, Phillips de Pury is proud to specialize in hot-off-the-press work. And where Chris-

**“We had to set ourselves completely apart. People said we were crazy at the time, but it's the smartest thing we've ever done”**

—Simon de Pury

and Sotheby's have long cultivated the old-money social establishment, de Pury's gallery has courted young hedge fund millionaires and other rookie collectors. Its hip aesthetic is evident everywhere, from the nude Mario Testino fashion photos in the reception area to an advisory board that includes former Sex Pistols manager Malcolm McLaren and designer Marc Jacobs.

Like the real Mick Jagger, de Pury is nothing if not a shrewd businessman. His ultracontemporary works, which he specializes in, are the



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rapidly appreciating objects in the art market. Now, the much larger Christie's and Sotheby's are playing catch-up, selling works by young artists such as Barnaby Furnas, jazzing up their catalogs, and holding special auctions for new work. Phillips de Pury's ascendancy is all the more impressive because it was widely given up for dead a few years ago—until de Pury engineered a turnaround worthy of a B-school case study. “He’s done an extraordinary job... tapping into the energy in the market right now,” says veteran New York art consultant Kim Heirston, whose clients include Kate Spade and Tom Clancy.

Of course, the contemporary art bubble



could pop—and there are those who wonder whether Phillips would burst with it. Marc Porter, president of Christie's America, which auctions everything from wine to books to ancient art to vintage cars, says: “I’d rather [have] our business model than theirs.”

De Pury is unperturbed. As the fall auction season approaches, the company is headed for a second straight profitable year, after many years of losses. And de Pury has lined up a long list of trophy properties to sell. “Our results speak for themselves,” he says, flanked in his wall-less office by nine giant metallic globes by Richard Armleder, a contorted Ron Arad steel chair, and a row of white vases decorated with images of Chairman Mao. The atmosphere, like the airy gallery space, is chic, fun, and slightly rebellious.

That sensibility has been carefully calibrated by de Pury, 55. After serving as chairman of Sotheby's in Europe for 11 years and managing the celebrated

**NEW OLD SCHOOL**  
A 2005 painting by  
Kehinde Wiley

## Rising Stars

Interest in the work of young artists, some fresh out of graduate programs, is skyrocketing. Here are a few of the hottest talents:

### BARNABY FURNAS

He's known for apocalyptic scenes of floods and war. In the spring, his *Blown to Bits* sold for \$396,800 at a Sotheby's auction. “I’d rather a more gradual ascent [in prices for my work], not this crazy spike,” Furnas says.

### KEHINDE WILEY

His hallmark is the juxtaposition of modern hip-hop cultural elements and old European settings. Larger works will set you back \$80,000, if you can get one.

### DANA SCHUTZ

Schutz's chunky, figurative paintings with absurdist and satirical themes have won her a solid following. Her *Project at Kensington* sold for \$96,000 at Christie's last fall, a personal record. She is now holding off on interviews and her gallery, Zach Feuer in New York, is imposing restrictions on sales to private collectors.

Thyssen-Bornemisza collection in Madrid, de Pury was well known in the art world. In 2000, LVMH Moët Hennessy chief Bernard Arnault, who had just bought Phillips, recruited de Pury, hoping his star power, connections, and the addition of his name would enable the second-tier, 210-year-old London firm to

become a global rival to the major houses.

After three years of wooing sellers with inflated guarantees, Phillips (then called Phillips, de Pury & Luxembourg) was running up debts. By 2004, cumulative losses, says Phillips' managing director Brook Hazelton, eventually reached \$400 million. As the red ink gushed, in 2002, LVMH drastically reduced its stake in the business to 27.5% from 72.5%. “We lost our most powerful partners; I was on my own without LVMH behind me,” de Pury says.

### UNORTHODOX MOVES

SURVIVAL WOULD MEAN bold steps. In early 2003, at de Pury's direction, Phillips pulled out of the competitive Impressionist and modern art auction markets, relocated from an haute Midtown Manhattan location to a cheaper one downtown, and later reformatted its catalogs to look more like

fashion magazines—all unorthodox moves for a major auction house. De Pury also decided to focus on four categories: contemporary art, design, jewelry, and photography. “We had to set ourselves completely apart,” he says, sitting on a steel pipe bench/bookshelf in the office he furnished. “People said we were crazy at the time—it's the smartest thing we've ever done.”

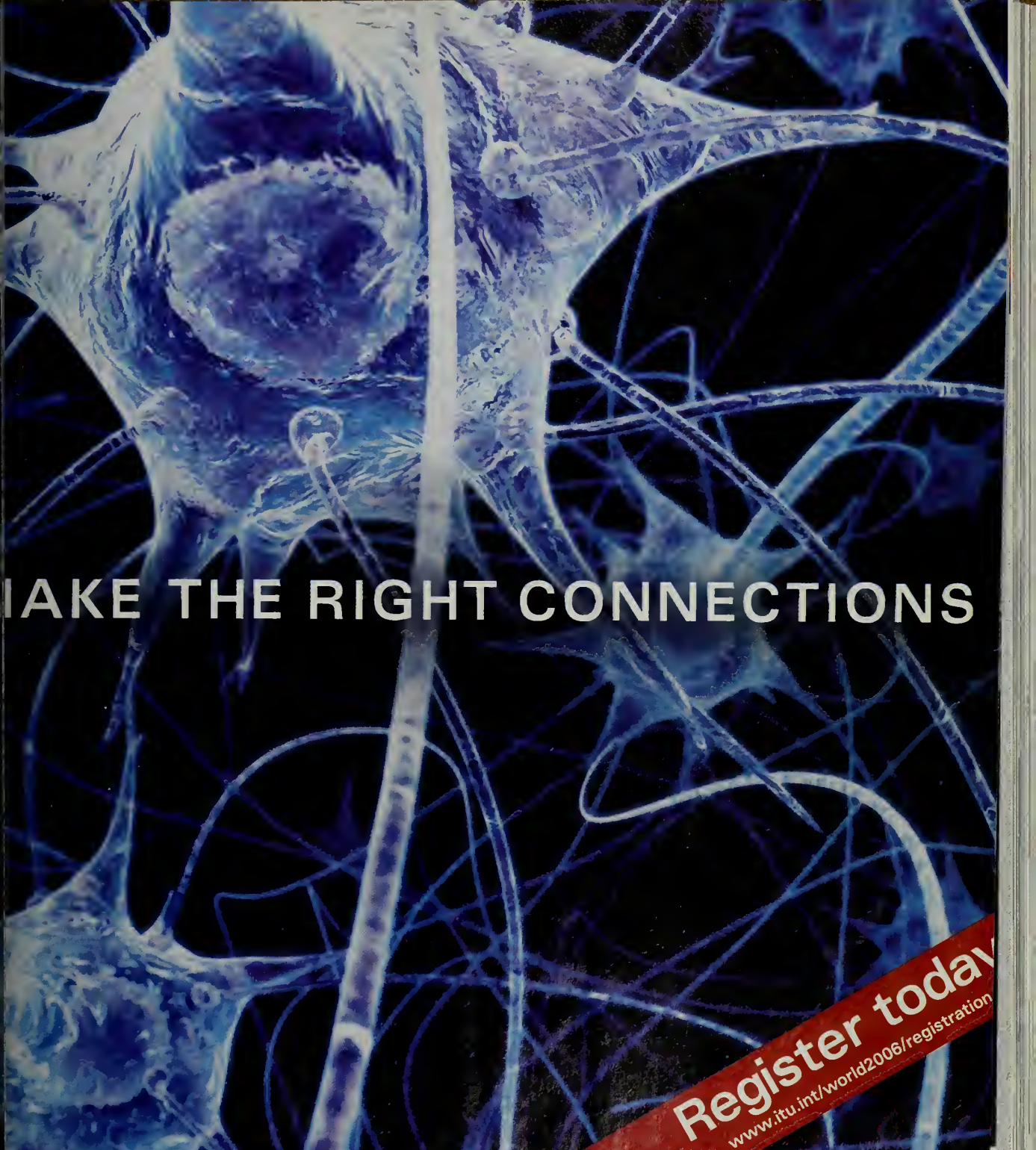
In fact, de Pury hit some of the hot precincts of the art world. Over the five years, contemporary art has appreciated at a compound annual rate of 17.69%, according to Jaioping Mei Michael Moses, two professors at New York University's Stern School of Business who publish an index of art performance. By comparison, Impressionist works and Old Masters have appreciated 7.73% and 3.13%, respectively. “Collecting Old Masters just seems a little [stagnant] for some of our younger generation,” Moses says. Photography has done best, rising 25% to 30% for each of the past five years, estimates Stephen Perloff, editor of *Photo Review* and *Photograph Collector*.

Overall, Phillips' sales are still dwarfed by Sotheby's and Christie's. It eked out a modest profit (“in the single-digits,” according to Hazelton) on sales of \$103.2 million in 2005, while Christie's global sales totaled \$3.2 billion, followed by Sotheby's at \$2.7 billion. Christie's does not disclose profits, but Sotheby's earned \$63.2 million last year.

But Phillips is developing an edge: so-called wet paint art—work so new that the paint is still drying on the canvas. It's a closely watched spring contemporary art evening auction in New York, for example, it beat the two big houses for the first time produced in the 21st century, selling \$6.6 million worth of such art, compared with \$1.4 million at Sotheby's and \$4.7 million at Christie's. Phillips may have the lead in a vague but crucial metric: buzz. The latest, most controversial work is skyrocketing in value for one reason: It appeals to the bold names and Wall Street dynamos who lead the next generation of collectors.

De Pury has adeptly catered to a set of first-time buyers, upwardly mobile twenty- and thirtysomethings who spend \$600 on Prada shoes but have to step into the auction world. For this audience, Phillips launched a new “basement sale” series in September called *Sunday@Phillips*. The series features music, coffee, and bagels, de Pury and items selling from \$500 to \$20,000. “We want to take the fear away,” he says. “[to] encourage people to see how profitable auctions can be.” ■



An abstract graphic featuring a dense, interconnected network of blue and white lines, resembling a complex web or a neural network, set against a dark background.

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# Getting Fit Glued to the Tube

The sporting goods biz is using video games to pry potatoes off the couch

BY JOHN CAREY

**B**RIAN WILLIS IS EXPERTLY steering an all-terrain vehicle up hills and around obstacles on the screen in front of him, leaving his competitors in the dust. But the 41-year-old self-professed "video gamer" is not sitting on a couch. He's pedaling furiously on a stationary bike, sweat dripping from his brow.

To win the ATV Offroad Fury game, Willis, an Internet security maven at Intel Corp. in

Seattle, pedals faster and faster, getting a good workout. "You lose yourself in the game," says. Over the past year he has trimmed 100 pounds from a body that had ballooned near 500. He can fly-fish again and is close to getting back into his surfing wet suit. "I feel really good getting back to the things I love," he says.

In Naperville, Ill., near Chicago, Phil Lavigne, 56, is pacing the gym at Madison Junior High, overseeing 35 rambunctious eighth-graders. No dodgeball here. Some kids are dancing in a storm, stepping on a mat as they follow the



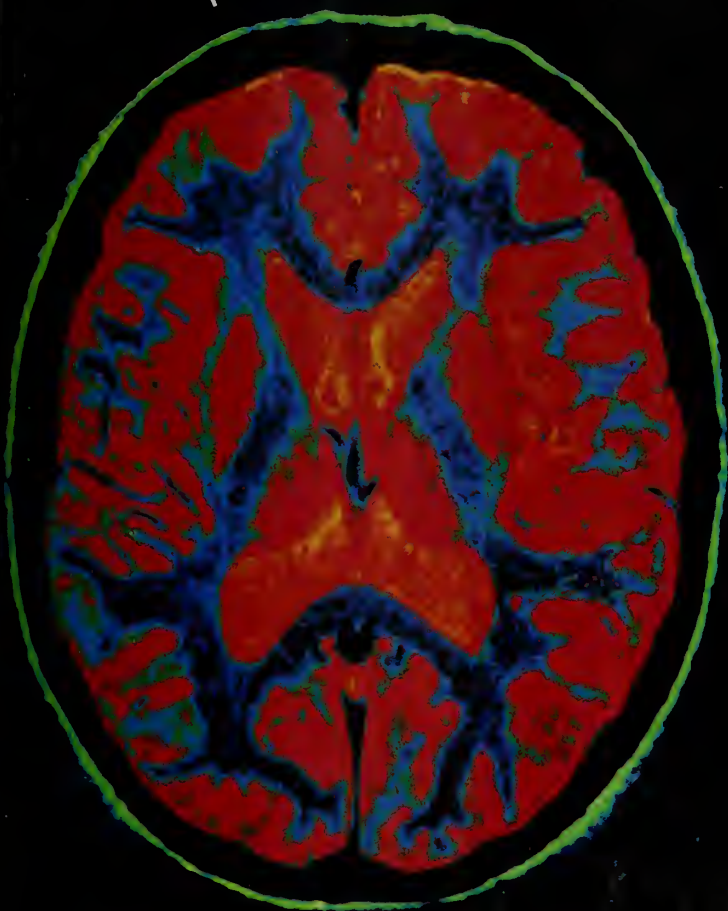
#### MAKOTO ARENA

Players hit targets on three towers when bells sound and lights flash. It's a hit with schools and pro sports teams

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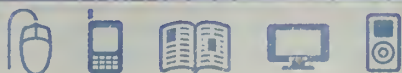
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**BusinessWeek**







**VIRTUAL BIKING** from VCycling lets riders see the scenery and feel the road as they pump up hills and down—on good days or bad

rections of big arrows on a screen in a game called Dance Dance Revolution. Others play video games on exercise bicycles. Still others throw balls against a "Sport-wall," trying to hit lights as they blink.

There's no mystery about why America's youth are getting fatter and less fit, says the Iowa-born Lawler, a cancer survivor and tireless advocate for physical fitness: "Blame screen time—TVs, computers, video games. But the best way to destroy your enemy is to make him your friend. So we are making this interactive exercise our friend, and boy, are the kids hooked on it." While he has no historical data for comparison, in the 21 schools that Lawler oversees, 3% of children are overweight, vs. a national rate near 20%. "Every school should be offering what we are doing," he says.

Flash back six years. The president of Wilson Sporting Goods, Jim Baugh, is contemplating the decline in Americans' participation, almost across the board, in sports and physical activities. Tennis, down 22% between 1987 and 2000. Baseball, down 28%. Aerobics, off 60%. The future looked bleak for the sporting goods industry, Baugh realized. More important, the nation itself was in a growing health crisis, with rising rates of obesity and related diseases such as diabetes. "I

saw the trends and said: 'Oh my God, America is forgetting that we need active bodies for active minds,'" Baugh recalls.

He jawboned the industry into creating an organization to reform phys ed, called PE4Life. The goal: to create new generations of fitter Americans—who would buy more tennis rackets, baseball bats, and other gear. The group has turned gym classes in hundreds of schools into hotbeds of experimentation. One of its gurus is Phil Lawler, who trains other teachers in a PE4Life academy.

But that's just one part of a larger effort by the industry to turn back the tide. The main weapon: technology. Kids are already hooked on computers and video games. "But we can trick them into

exercising," says Richard Kentopp, C Source Distributors Inc., distributor of Japanese bicycle accessory maker C Co. Kentopp started selling \$1,100 \$1,699 GameBikes, which act as controllers for PlayStation or other game consoles. "It is truly a huge market and opportunity," says Cathi Lamberti, C Sportwall International, which is jumping in with a competing product and environment such "game" bikes becoming fixtures in health clubs, schools, and medical centers.

When Icon Health &

ness Inc., with a 55% share of the \$3 billion-a-year treadmill market, added to its products this spring the TV machines outsold the old kind 2 to 1. The treadmills come with programs that enable homebound walkers to trek through California's redwoods or across Hawaii's beaches.

Companies big and small are jumping on the technology bandwagon, trying to grab part of the \$5.2 billion fitness products market that can steer through the recession on VCycling's new virtual reality trainer, created by John Gardner, a retired financial planner turned entrepreneur. You can insert your own video games with the Corp.'s EyeToy, where

**GLOVES ON**  
Boxing with Jackie Chan at XRtainment Zone in Redlands, Calif.





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movements control the on-screen character, and which has sold millions since being introduced in 2003. You can "fly" a jet fighter by pushing and pulling on a control stick from Powergrid Fitness Inc., or swing a baseball bat or box with Jackie Chan on your TV with XaviX' active game system, with sales in the hundreds of thousands since a 2004 launch.

Pro teams like the National Football League's Denver Nuggets, as well as schools and rehab centers, have embraced the Makoto arena, where players hit targets on three towers when bells sound and lights flash. The Konami Corp. arcade game that became a craze in Japan, Dance Dance Revolution, is catching on in schools and has been installed along with GameBikes at two pilot gyms in McDonald's restaurants. The companies are looking to make money, of course, "but we really do have very noble and altruistic goals about wanting people to be fit," says Colleen Logan, Icon vice-president for marketing.

Whatever companies' motives, the nation's lack of physical activity is being linked to a host of health problems. And new studies show that learning may suffer as well. Research on exercise is one of the hottest areas of neuroscience right now, says Dr. John J. Ratey, associate clinical professor of psychiatry at Harvard Medical School: "The effect of physical activity on the brain is huge."

John Stevens, 53, school superintendent in Grundy Center, Iowa, is a believer. His district has enthusiastically embraced the PE4Life model. Kids use the new high-tech exercise games, and teachers chart their progress in measures like cardiovascular fitness and body composi-

**GAMEBIKE** from Japan's CatEye keeps kids busy pedaling because it functions as a controller for PlayStation games



tion as rigorously as their math scores. "In the past two years our school has been the state champion in the academic decathlon, and last year we won the 'all-sports' award in Iowa," says Stevens. "That's more than a coincidence. We have all kinds of evidence that exercise is good for kids academically."

One key technology: heart rate monitors. When Iowa PE teacher Beth Kirkpatrick first began to use the devices, she found that "the standard approach to teaching PE was dead wrong." The kids were hardly getting any exercise. But the monitors helped grab even the exercise-phobes, and each kid was able to make progress at his or her own level. And with activities tailored to individual abilities, they were motivated to work far harder.

Polar, the leading heart rate monitor company, hired Kirkpatrick to head up a division aimed at the school market. The Lake Success (N.Y.) company's products are now used by children in 10,000 schools in the U.S. And "hopefully they will be Polar customers for life," says Gina Pilnacek, marketing manager for Polar's education division.

The approach seems to motivate adults, too. Former Wilson President and PE4Life founder Jim Baugh is now president of the Tennis Industry Assn. With grass-roots programs such as

"cardio-tennis," he has boosted participation by 10% since 200 only major sport not to suffer coing declines.

Of course, no one expects tech to turn a nation of couch potatoes into one of athletes or fitness buffs. Affbasements and garages are full of used NordicTracks or treadmills. Still, wonder if virtual reality and "video gaming will even make a difference the problem. Just throwing in technology doesn't mean people will exercise," cautions Kim B. Blair, director of the Center for Sports Innovation at Massachusetts Institute of Technology. But help ease the learning curve for challenging sports like golf, he says. In fact, founded a company, iClub, to market MIT-designed sensor-studded club records and analyzes precise details of players' swings.

The central challenge is today's sedentary world. "I rode my bike to school played in the woods with my buddies doing chores," recalls Kenton. "With today's highly protective parents, you can't do that anymore."

Out in Redlands, Calif., Ernie Miller Jr., a doctor of public health, is looking for that one solution to the problems of the new world is his XRtainment Zone commercial facility crammed with Bikes, Makoto arenas, Sportwall and other equipment. It had its grand opening on Sept. 14. "We are trying to get people who don't exercise," he says. "We're stealth exercising." ■





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# Still Working And Loving It

With retiring boomers expected to cause a shortage of skilled staff, employers are making it easier for them to stay. **BY TODDI GUTNER**

**B**RIGITTE SCHONER, A 58-YEAR-OLD molecular biologist, faced a dilemma earlier this year: After 23 years at Eli Lilly she was eligible to retire with full pension and health benefits, but she still wanted to work. Now she's officially retired

and has the best of both worlds: challenging and rewarding work with a nice hourly income similar to what she earned at Lilly. Schoner does the same type of projects she did at Eli Lilly, but only when and where she wants. "I manage my work life according to my personal needs," says Schoner, who puts in up to 30 hours a week, leaving her plenty of time to take long bike rides and jogs near her Monrovia (Ind.) home.

Her employer is YourEncore, a company that contracts with major corporations nationwide to provide retired scientists, product developers, and engineers with full- or part-time work. "Demand is strong for these professionals who have well-honed skills," says Brad Lawson, CEO of YourEncore.

Lawson is taking advantage of what experts predict will be a shortage of workers with specific skills and talent as 77 million baby boomers reach retirement age and the number of seasoned professionals to replace them falls short. With an estimated 20% of the U.S. workforce age 55 or older by 2011, from 14% in 2002, "employers are going to need to hire people of any age as long as they have the experience the companies need," says Mary Young, a senior researcher for strategic workforce planning at the Conference Board.



That's good news for the graying masses who want to stay in the game. And there's a shortage of them. A 2005 Merrill Lynch survey of more than 3,000 boomers reported that 83% intend to keep working after retirement, and 56% of those who don't plan to retire hope to do so in a new profession. Those boomers don't change careers will be expected to shift gears at their current companies or take their skills to another occupation.

So where is there room for those retirees who want to continue to work? Experts have identified five areas that already face or expect to face labor shortages in coming years. In many cases employers are seeking out more experienced workers because they act as role models to younger professionals and have been found to be more reliable and loyal to their employers. To that end, these sectors are modifying their workplaces to include more flexible hours and more time off to attract and retain a mature worker.

## SITES THAT CAN HELP

**bls.gov/oco** The Bureau of Labor Statistics' occupational handbook includes job descriptions, work opportunities, and other details

**careervoyages.gov** Helpful information for career changers

**execunet.com** Networking for executives earning more than \$100,000

**matureservices.org** Posts full- or part-time positions for seniors

**retiredbrains.com** Job board for retirees who want to work

**retirementjobs.com** Job opportunities for folks over 50

**seniors4hire.org** Career center for employers and 50+ job seekers

Three children. Ten grandchildren. Twelve great-grandchildren. And over 4000 hours on water skis. Frank Shearer has loved every hour on skis almost as much as he loves his grandchildren. That's why he's still at it, almost 80 years after he first set foot on the water in 1926. Of course, skiing wasn't his only love during the past century. He also loved being a doctor.

When his practice  
began



in

1932, he was

paid \$5 for every baby he delivered. He started saving for retirement during his first year of practice, and he's been happily retired for decades. Genworth Financial's retirement income solutions can provide you with options to help meet the challenge of funding a vibrant, active future by giving you retirement income you can't outlive. No matter how long that may be.

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Frank's life, visit  
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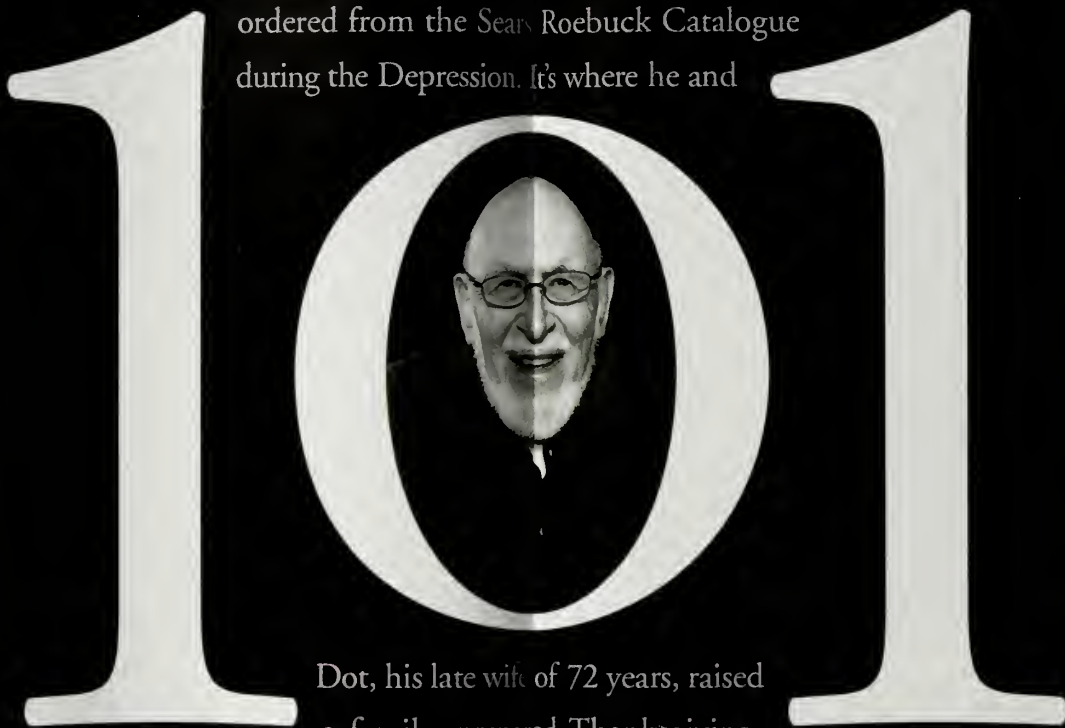
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In 1930, astronomers discovered Pluto. And Ed Rondthaler discovered the joys of home ownership. Ed Rondthaler, age 101, has been living in his own home near the Hudson River since Hoover was President, and he has no plans to leave anytime soon. His house isn't just a two bedroom, one bath bungalow

ordered from the Sears Roebuck Catalogue during the Depression. It's where he and



Dot, his late wife of 72 years, raised a family, prepared Thanksgiving turkeys, and decorated Christmas trees for almost eight decades. At Genworth Financial, we recognize the importance of the freedom that comes with being able to live in your own home as long as possible. That's why our long term care insurance can help people stay in their own homes longer, enabling them to receive benefits right where they need it most – where their heart is.

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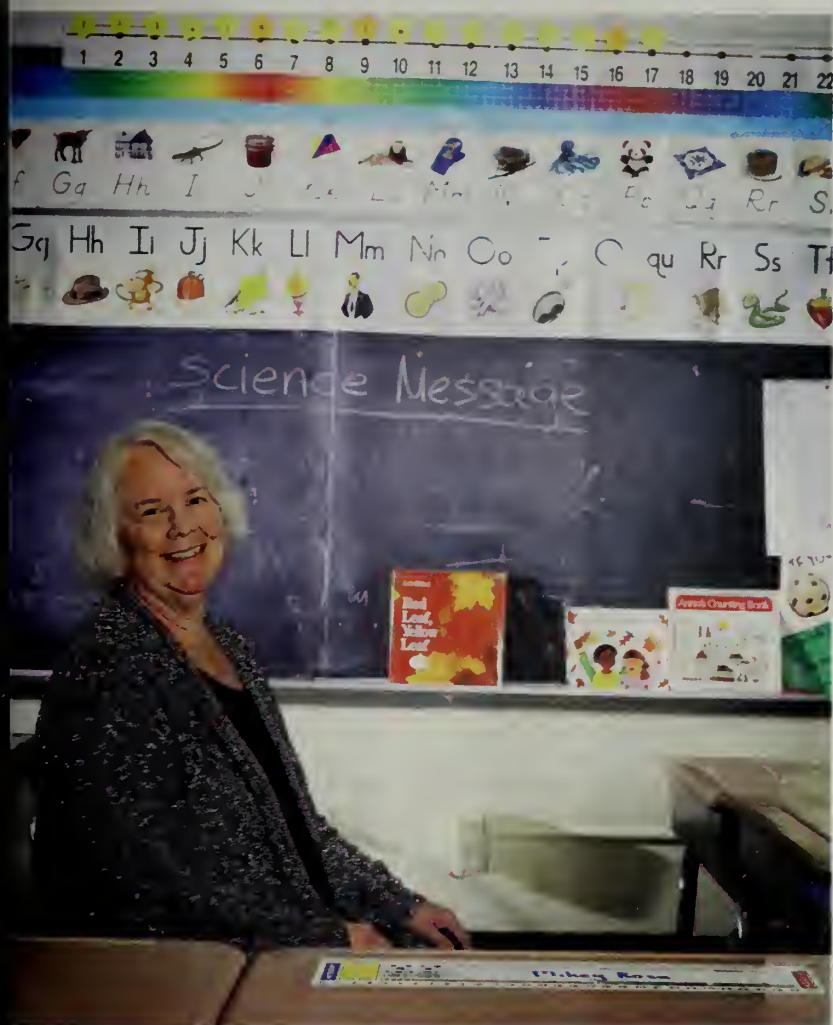


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## LEARNING PERIENCE

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# Still Working And Loving It

With retiring boomers expected to cause a shortage of skilled staff, employers are making it easier for them to stay. **BY TODDI GUTNER**

**B**RIGITTE SCHONER, A 58-YEAR-OLD molecular biologist, faced a dilemma earlier this year: After 23 years at Eli Lilly she was eligible to retire with full pension and health benefits, but she still wanted to work. Now she's officially retired

and has the best of both worlds: challenging and rewarding work with a nice hourly income similar to what she earned at Lilly. Schoner does the same type of projects she did at Eli Lilly, but only when and where she wants. "I manage my work life according to my personal needs," says Schoner, who puts in up to 30 hours a week, leaving her plenty of time to take long bike rides and jogs near her Monrovia (Ind.) home.

Her employer is YourEncore, a company that contracts with major corporations nationwide to provide retired scientists, product developers, and engineers with full- or part-time work. "Demand is strong for these professionals who have well-honed skills," says Brad Lawson, CEO of YourEncore.

Lawson is taking advantage of what experts predict will be a shortage of workers with specific skills and talent as 77 million baby boomers reach retirement age and the number of seasoned professionals to replace them falls short. With an estimated 20% of the U.S. workforce age 55 or older by 2011 from 14% in 2002, "employers are going to need to hire people of any age as long as they have the experience the companies need," says Mary Young, a senior researcher for strategic workforce planning at the Conference Board.

That's good news for the graying masses who want to stay in the game. And there's a shortage of them. A 2005 Merrill Lynch survey of more than 3,000 boomers reported that 83% intend to keep working after retirement, and 56% of those hope to do so in a new profession. Those boomers don't change careers will be expected to shift gears at their current companies or take their skills to another occupation.

So where is there the room for those retirees who want to continue to work? We identified five areas that employers already face or expect to face labor shortages in coming years. In many cases employers are seeking out more experienced workers because they are role models to younger professionals and have been found to be more reliable and loyal to their employers. To that end, these sectors are modifying their workplaces to include more flexible hours and more time off to attract and retain a mature worker.



## SITES THAT CAN HELP

**bls.gov/oco** The Bureau of Labor Statistics' occupational handbook includes job descriptions, work opportunities, and other details

**careervoyages.gov** Helpful information for career changers

**execunet.com** Networking for executives earning more than \$100,000

**matureservices.org** Posts full- or part-time positions for seniors  
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## Government

Linda Springer, director of the U.S. Office of Personnel Management, has one tough challenge. An expected 90% of civilian senior executives in the federal government (and 60% overall) will be eligible to retire in the next decade. Springer's job is to stem the brain drain of experienced personnel—from chief financial officers and engineers to human resource managers and scientists employed in agencies from NASA to the National Institutes of Health—and entice these highly trained professionals to stay on.

Springer is spearheading a massive personnel management reorganization that will turn the traditional 9-to-5 must-be-in-the-office government routine on its head. By early next year she is requiring every federal agency to catalog each job to determine what degree of flexibility the position can sustain. She is also working to get legislation passed that will remove the penalties that government employees incur when they move from full-time to part-time work. "It's imperative for the U.S. government to embrace flexible [workplace] alternatives" such as part-time schedules, working from home, and job sharing in order to compete for talent, says Springer.

One retiree who is already benefiting from such flexibility is Walter Benson, an electrical engineer and former professor who is now a full-time patent examiner for the U.S. Patent and Trademark Office in Alexandria, Va. The USPTO incorporated Springer's vision a few years ago, in part because of an acute shortage of experienced employees. Demand continues to be high since the USPTO plans to hire 1,000 new patent examiners each year for the next few years.

As long as Benson, 66, meets the office's production schedule, he can work his 40 hours on the days he chooses. That leaves plenty of time for him and his wife to enjoy their two homes, one in Pennsylvania's Pocono Mountains and one on Pawleys Island, S.C. "I wanted to continue with my profession, and I haven't felt any need to leave the workforce," he says.

### FULL-TIMER

Retired engineer Benson became a patent examiner





## Financial Services

Many professionals who are seeking a new career need to go back to school. Patricia Rudolph needed to leave school. After 25 years of teaching at the University of Alabama, she could have retired with full benefits and a pension. But she was only 52 at the time. So Rudolph returned to her home state of Maryland and taught at American University in Washington, D.C., for four years.

Financial planning was one of the courses she taught there, and that sowed the seeds of her new career. Now 57, Rudolph recently launched a financial-planning practice in Columbia, Md. She joined Garrett Planning Network, a group of fee-only financial planners that provides a business model and training for independent planners. "The process of beginning a new business is much more consuming than I had realized," says Rudolph. Her goal: one new client a month. "So far, so good," she says.

Rudolph's plan is to serve middle-income families—"people with less than \$500,000 in assets and maybe even some debt problems." That, she figures, is an underserved market. After all, 75% of financial planners only accept clients who have a minimum of \$500,000 in investable assets and \$1 million in net worth, says James Barnash, managing director of Lincoln Financial Advisors and chairman of the Financial Planning Assn. "As boomers start to figure out their retirement-income strategies, the need [for planners] is going to be enormous," he adds.

Financial services is one industry in which gray hair can only help. "Consumers are more likely to trust people who look like them," notes Robert Morison, executive vice-president of the Con-



**OUT OF ACADEMIA**  
Rudolph, a former finance professor, is now a financial planner

## MONEY-MINDING JOBS

**efinancialcareers.com** Job board for full- or part-time work in finance  
**finance.theladders.com** Opportunities in financial services  
**jobsinthemoney.com** Available positions in financial services  
**nbn-jobs.com** Job listings in financial services  
**schwabtransitions.com** Find or post career opportunities

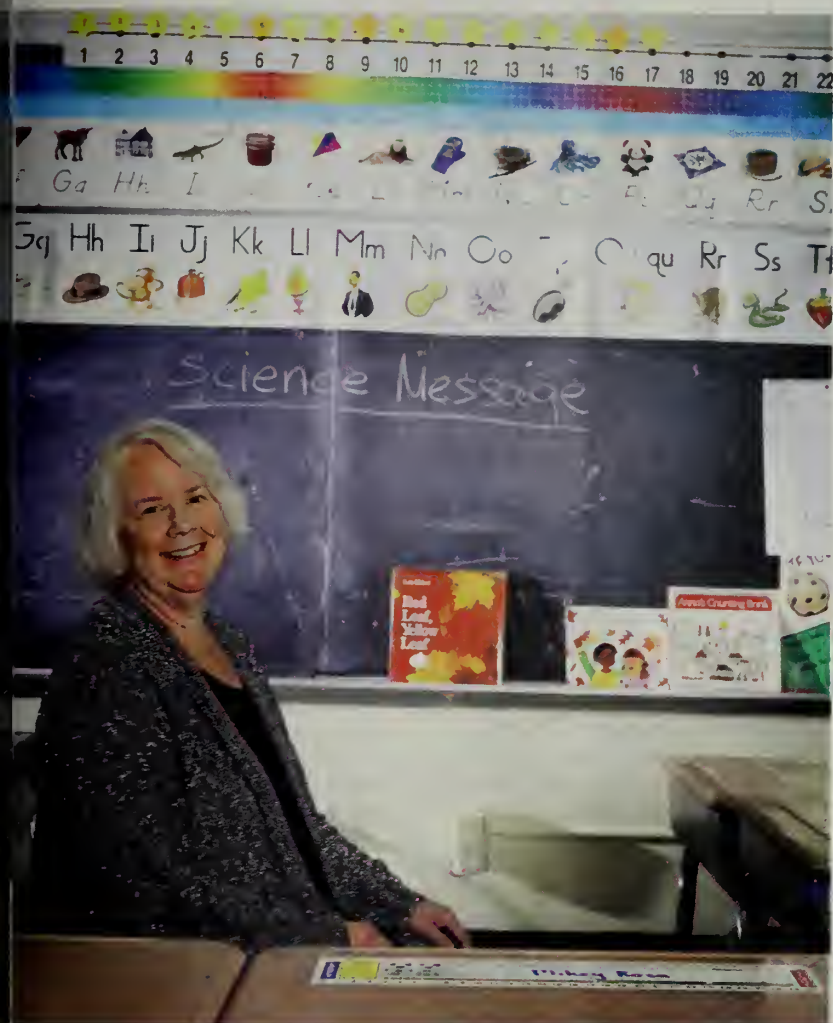
cours Group, a human resources consulting firm in Watertown, Mass.

## Education

Attrition, retirement, and increasing enrollment have converged to create an acute shortage of teachers, especially in urban school districts. The U.S. Dept. of Education estimates that there will be a shortfall of 200,000 teachers nationwide by 2014. To fill the gap, fast-track alternative teacher certification programs for professionals with bachelor's degrees have been created in 43 states. In 2004, only five teachers in New York,

Manual of  
PATENT  
EXAMINING  
PROCEDURE





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## LET'S GET MEDICAL

**ama-assn.org** Career trends in the field

**ashhra.org** Job postings for all types of health-care positions

**discovernursing.com** Information on jobs and training in nursing

**healthcareworkforce.org** Links to health-care job postings

**rxrelief.com** Job postings for pharmacists

Keeping nurses on the job is imperative. Because it's such physically demanding work, a number of hospitals have begun to install mechanical lifting devices to help nurses move patients. To help fill the 200,000 nursing jobs projected to be open by 2010, nursing schools nationwide are creating accelerated programs that award degrees in 12 to 18 months for professionals who hold a bachelor's degree in another field.

Robert Rickert, a 54-year-old former marketing executive with a degree in economics, is taking advantage of such a program at Case Western Reserve University.

Rickert was always interested in health care and decided to change careers after caring for his wife while she was ill with breast cancer for six years. She died in 1999. Rickert, who became an RN in January, is on his way to a doctorate in nursing. He says he finds the work "very fulfilling, intellectually challenging, and stimulating."

Michelle Flowers is a career changer who is benefiting from an in-hospital training program at Yale New Haven Hospital (No. 5 on AARP's survey). Flowers, 51, laid off from her flight attendant job in 2003, entered an accelerated nursing program in Bridgeport, Conn. She graduated in May and was immediately hired into Yale New Haven's nine-month training program for operating room nurses. "I am being paid a full-time salary while they train me," she says.

## Science &amp; Engineering

Professionals in these fields won't have any problem staying employed for as long as they want to work. From 1980 to 2000

the total number of science and engineering degrees earned grew at an annual rate of 1.4%, far below the 4.2% growth of science and engineering jobs, according to *Science & Engineering Indicators 2006* report from the National Science Board. What's more, nearly 30% of all science and engineering degree holders currently in the labor force are age 50 or older.

The result? Companies such as Stanley Consultants, an environmental, engineering, and construction firm in Muscatine, Iowa, will do whatever they can keep the old guard from retiring. The worldwide boom in construction—from emerging economies that need to build infrastructure to hurricane-stricken areas that need to rebuild—engineers are in huge demand.

"Our clients want the more experienced project managers, and they're willing to pay for it," says Greg Thomopoulos, CEO of Stanley Consultants, who notes that his oldest employee is 84. "If someone is doing a good job, is in good health, and wants to keep working, we're not going to push them out."

That's why John Sayles, a 40-year veteran urban planner at Stanley Consultants, is still doing projects for the firm. Sayles officially retired three years ago, at age 69, but just five months later Thomopoulos asked him to go to Iraq for three months to develop infrastructure improvements. "They call me when they need me," says Sayles. He spends one to two days a week reviewing reports for power plant sitings, New Orleans levees, and similar projects. ■■

**ON CALL** Urban planner Sayles, 72, works one or two days a week. His firm's oldest employee is 84



**BusinessWeek online** To watch a video report on the best jobs for people over 50, go to [businessweek.com/go/tv/fiftyjobs](http://businessweek.com/go/tv/fiftyjobs)

ENGINEERING  
A NEW JOB

**asme.org/jobs/** American Society of Mechanical Engineers' site for job postings

**engcen.com** Job board for all types of engineering work

**engineer500.com** To post or find an engineering job

**engineerjobs.com** Job postings for engineers

**engineeringjobs.com** Full- or part-time work for engineers

**nationjob.com/engineering** Opportunities in engineering

**yourencore.com** Contract work for retired engineers





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# How to Quit—Without Quitting

What you need to set up a consulting business after you leave the office

**BY LARRY ARMSTRONG**

**T**IME TO RETIRE, BUT NOT quite ready to hang up your spurs? Going into business for yourself as a consultant, using the contacts and skills you gained on the job, lets you slow down your work life to a pace you can control. You can set your own hours, choose your own clients, and pay your own salary.

If you're one of the lucky ones, you can snag a consulting contract with your soon-to-be-former employer. That will at least get you started. In any case, here are some tips for setting up a consulting practice:

**START SMALL.** It's easy to set up a fully outfitted home office for less than \$1,000, and that's what you should do. Keep your fixed expenses as low as possible, especially if you're counting on the proceeds of your business to fund your retirement, or even part of it. A rule of thumb: It will take a year or two before you turn a profit and three before you'll be making a living. If you're more comfortable with a formal workplace and having access to a conference room and overhead projectors as well as someone to answer

the phones, rent space in a commercial office suite.

**KNOW YOUR COMPETITIVE EDGE.** Years of corporate downsizing, self-claimed consultants are ubiquitous. If your skills are unique or scarce in the market, go after that niche and build it as you gain expertise. When John pola retired from the Smithsonian Institution in 1995, he planned on being a freelance curator, putting together exhibitions for museums. Comfortable speaking in Spanish as well as English, the Miami consultant today gets most of his business from museums in Latin America and the Caribbean. And he's now mounting shows: "I found that what museums really need is strategic planning advice and professional development."

**WRITE A BUSINESS PLAN.** It can be brief, maybe just two pages. But it should help you define your business, tell whether there's a potential for profit, forecast your cash flow—important when projecting the investment you'll need to get up and running. If you've never written a business plan before, this would be a good time to hire a coach to guide you through it. Expect to pay around \$50

of formal sessions, but often you find someone to help you for free, a former professional associate who already has an established consulting practice.

**BE ENOUGH.** You're going to incur pocket expenses working for a company that you don't have as an employee. For example, your Social Security and Medicare taxes will double. You also have your own health and disability insurance, and there's no such thing as a paid holiday or vacation. A common mistake is to bill your clients 2½ to 3 times what they'd have to pay an employee for the same job.

**PROFESSIONAL ASSOCIATION.** In many cases, several. Besides keeping up your dues in trade groups affiliated with your industry, which you need to stay current, you should become active in local consulting associations. Every major city has several. "Networking and referrals are absolutely essential in this business," says Tom Northup, a 61-year-old management consultant in Rancho Palos Verdes, Calif., who spent 30 years as a sales executive for such companies as IBM, Cisco,

and Nortel before retiring six years ago. "It's the best way of seeing how other people are doing the same thing, right or wrong."

One association, the Institute of Management Consultants ([imcusa.org](http://imcusa.org)), is the only group that certifies such consultants; that certification can differentiate you from your rivals. The associations can also put you in touch with service providers, such as accountants and attorneys, that you need to help run your business.

**MARKET YOURSELF.** While you're at it, join an organization that will teach you how to speak on your feet more effectively, such as Toastmasters International. It's an essential skill. Referrals from clients and associates, and companies that ask you to bid for their business, provide a more reliable income stream than cold-calling prospects does, and seminars, speaking engagements, and mentions in newspapers and magazines are what bring in that kind of business.

"Selling yourself is not like selling some widget," says Tom Northup, 65, who had retired after 30 years in manufacturing. It took just a year for him to figure out that retirement wasn't for him, and he became a

consultant in Newport Beach, Calif. "Most people are going to have to learn new skills and techniques, or they aren't going to be successful."

Besides joining Toastmasters, Northup hired a consultant to build his Web site. He engaged a coach to help him develop a stump speech that he can deliver on a moment's notice. He writes articles for a newsletter that goes to clients and prospects, but they're edited by a consultant "to make them really sing," he says.

When you're ready to start your consulting business, plenty of resources can help. For a general look at what it takes, pick up *Getting Started in Consulting* by Alan Weiss. For the nuts and bolts, you can't beat *Working for Yourself: Law & Taxes for Contractors, Freelancers & Consultants*, by Stephen Fishman.

Whatever you do, don't look like you're retired. "If you sit down with clients looking tanned and relaxed, it can work against you," says Bob Clyatt, author of *Work Less, Live More: The New Way to Retire Early*. "You don't want to make this look like a hobby, or like you're just puttering around." Even if that's what you're really doing. ■

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**BETTER BUSINESS**  
Bretos (left) provides help to seniors who live in public housing

ing agreement by the U.S. Housing ban Development and the Health man Services Do work together to these services i

wide. "It is one highest achievements of my life," says. She is far from slowing do hope to do it until the day I die, be don't see it as work," she says.

Instead of just retiring from the many working lives at 50-plus, and so-called social entrepreneur her are starting companies and profits that apply new business sol to intractable social problems fields of housing, education, heal and the environment, among a "There is a groundswell of boomers who are on fire about ma difference in their community an world," says Sally Osberg, CEO Skoll Foundation, founded by Jeff first president of eBay, to invest in entrepreneurs worldwide.

Starting nonprofits or working greater good is no easy or inexp task. Still, it has become a little les cult in the past few years. Since 2 handful of organizations flush wit have sprung up to help these social preneurs get off the ground with funding and guidance (table). Wi exception of Civic Ventures, most groups are backed by extremely su ful people in the hedge fund and v capital worlds.

#### LATE-ONSET IDEALISM

KNOWN AS VENTURE philanthr these individuals and their organiz have adopted the rigorous due dil used in for-profit venture capital i ments to find and support those wh create significant social change. foundations also incubate social preneurs' organizations and provi kind of networking and strategic tion given to for-profit investments year, new grantees, or fellows as t called, are chosen and financed.

Civic Ventures is different in a respect: It is the only group that fr solely on the aging baby boomer year a Civic Venture survey of 1,00 ple aged 50 to 70 found that nearl in five participants in their 50s sai wanted to use the next chapter o lives to improve the quality of life i communities. To further encourag altruism, Civic Ventures created th pose Prize, five \$100,000 and

# Activism Isn't Just for Kids

Venture philanthropy is helping retired baby boomers become social entrepreneurs. **BY TODDI GUTNER**

**A**S FLORIDA'S SECRETARY for aging and adult services in the mid-1990s, Conchy Bretos got a close look at a huge population of seniors who were terribly neglected: the elderly poor living in public housing. "I visited seniors who hadn't been out of bed in days," says Bretos. These people often ended up in nursing homes prematurely because they couldn't afford in-home care. Bretos had a

brainstorm: What if she brought assisted-living services to public-housing residents who needed just a little help to remain in their homes?

She did just that. Bretos, now 60, launched MIA Consulting Group in Miami Beach with her own money. Her for-profit company has helped 40 public-housing projects in 12 states bring assisted-living services to their residents. She obtains waivers that allow Medicaid funds to be used to keep people in their homes. Her pièce de résistance is a pend-



10 cash gifts given to 15 social entrepreneurs aged 60 or older (Atlanticthropies and the John Templeton Foundation have donated \$9 million to the first three years of the award). In 2007, the first winners were announced. Bretos, who competed with other applicants, was one of the five winners on a \$100,000 award. Hers was the first profit-making venture on the list. On Oct. 15, Civic Ventures will take applications for its 2007 Purpose Fellows.

While the other groups do not have an age requirement for their applicants, they are seeing increasing numbers of older entrepreneurs applying for grants. For example, Ashoka, the oldest and largest program that supports social entrepreneurs with 1,800 fellows worldwide, packs 15 to 20 new fellows per year. In 2007, Ashoka (named for an Indian emperor who devoted his life to helping humanity) elected 13 fellows, of whom a number of five were over 50 years old. Charlotte Frank of New York, 70, is one of them. She co-founded The Transition Network, a national organization for people over 50 that helps them channel their skills and experience into volunteer

## SUPPORT FOR SOCIAL ENTREPRENEURS

These organizations are backed by hedge fund managers, venture capitalists, private-equity firms, and foundations. Besides financial support, they provide advice and networking opportunities.

**Ashoka/ashoka.org**

**Blue Ridge Foundation NY/brfny.org**

**Civic Ventures/civicventures.org**

**Draper Richards Foundation/  
draperrichards.org**

**Echoing Green/echoinggreen.org**

**Skoll Foundation/skollfoundation.org**

projects that address social issues. For example, members have mentored disadvantaged women in job training, equipped a library at a school for disabled children, and helped seniors navigate the Medicare drug program. Depending on financial need, Ashoka gives individuals an average of \$50,000 each year, for three years.

Blue Ridge Foundation New York is more generous in its grants, but it restricts them to organizations based in the

Big Apple. So far, Herb Sturz has received \$100,000 from Blue Ridge to launch ReServe, a not-for-profit organization that places skilled retirees in part-time positions with New York City social service and government organizations that need, but can't afford, qualified help. Since its launch a year ago, ReServe has placed 83 retirees in various jobs at places such as the American Museum of Natural History and the city government. Retirees receive \$10 an hour and work 15 hours a week.

"These seniors have so much to offer, and these jobs bring meaning to their lives," says Sturz, who has had a long career working on social issues as New York's deputy mayor for criminal justice and the chairman of the New York City Planning Commission, among other positions. ReServe follows on the heels of another program Sturz started called the After School Corporation, which involves 250 afterschool enrichment programs serving 40,000 kids. Its goal is to keep them off the streets and engaged in stimulating, worthwhile activities. At 75, Sturz still has a lot to offer, himself. With the aging baby boomers right behind him, it looks as if he'll be in good company. ■

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# MySpace for Baby Boomers

Monster.com founder Jeff Taylor thinks seniors should have a network, too. **BY AARON PRESSMAN**

**T**HE IDEA FOR JEFF TAYLOR's latest startup came out of left field. At a conference a couple of years ago, Taylor wanted to underscore how a coming labor shortage would create opportunities for Monster.com, the successful and disruptive online job site he founded a decade ago. Some 77 million retiring baby boomers were leaving the workforce, Taylor said. Someone in the crowd called out: "Where are they going?" "That's not my expertise," Taylor replied. But as his own 50th birthday drew near, the question started nagging at him.

So last year, he holed up after work in Boston on Monday nights to come up with an answer, furiously scribbling in the pages of a thick, spiral-bound black



notebook. Taylor's research reveals retiring baby boomers will not only have a lot more free time, but they will also have some \$1 trillion of disposable income and, unlike their Depressed Generation parents, the desire to spend it. They will also have more years to spend, too: Today's average additional life expectancy of someone who reaches 65 is 18 years, on average. Meanwhile, almost 8,000 people are turning 60 this year. What they needed was some engagement and a place to do with the rest of their lives.

## "LET'S LIVE TO 100"

TAYLOR'S ANSWER WAS Eons.com, a MySpace for baby boomers. A place where 50 and over can sign up, share retirement dreams with other members, blog about dating experiences or travel to Africa, and page through old photos and contribute photo

memories to a database of 77 million obituaries. Rather than decry the problems of aging, Taylor sees the promise of longevity. Indeed, the motto of his new enterprise is, "Let's live to 100 and die trying."

With black-rimmed glasses, a colorful striped shirt, and a goatee, Taylor, 46, wouldn't seem to have a lot in common with the AARP set. But trust him—he's jazzed. "I'm really in love with this topic," Taylor says almost apologetically when he finally pauses after a nearly 20-minute explication (with lots of thumbing through the original notebook).

Given Taylor's past success, it makes sense to pay attention to his ideas.

His first big idea—posting job postings and resumes online—became Monster.com, now the highest ranked employment site on the Internet. Operating in 32 countries, Monster had revenue of almost \$1 billion last year and a market value of nearly \$5 billion. The company's database includes 52 million résumés and listings for opening more than 200,000 companies.

No one doubts that there's a real chance to craft a better Internet experience for people over 50. The senior demographic is the fastest-growing group on the Internet, according to surveys by the Pew Internet & American Life Project. Of course, that's because it's starting from a small base: While almost 90% of people

**Will older folks take to Eons.com? It's no sure thing**



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to 40 are already online, only half of 60-year-olds and one-quarter of people in their 70s surf the Net. Aging boomers, who gained Web knowledge in the workplace, are forming a "silver tsunami" that will dramatically increase the older online population, according to Pew. Yet, in a huge misstep, that group has been all but ignored by most sites, says Jakob Nielsen, a Web usability guru and consultant. "It's not like once people turn 50 they close themselves off into a corner," he says.



Still, before any hard comparisons can be drawn between Eons and teen social networking phenom MySpace, Taylor and his crew have a lot to prove. For MySpace, getting tens of millions of members was the easy part. Attracting advertisers took longer. Eons faces the opposite challenge. Many companies, ranging from Fidelity Investments and Humana to Verizon Wireless, want to advertise online to wealthy boomers. The question is whether Eons can convince older folks that there's a reason to engage in online communities. Only 20% of people over 55 expressed an interest in using current social networking sites, compared with 75% of 18- to 24-year-olds, according to a 2006 survey by Jupiter Research. "There's a niche market, but it's a much smaller opportunity than for other groups," says Corina Matiesanu, a Jupiter analyst in New York.

## ROAMING THE HALLS

TAYLOR PLANS TO overcome boomers' resistance by combining practical services, members' own experiences, and corporate offerings. His goal? Put helpful resources behind Eon's inspirational pitch: "Do more, see more, learn more, be more." For instance, Eons asks people 50 and older to list goals for the rest of their lives and then offers articles, blogs, discussion boards, online tools, as well as advertising and marketing offers related to those desires. Since Eons' quiet public launch two months ago, about 50,000 members have signed up, with 10,000 setting up goals, including visiting China, milking a cow, and learning cake decorating.

## Eons' call to boomers: 'Do more, see more, learn more, be more'

a startup environment that fit his view of Eons as a place where boomers could gather and forge more interesting lives in retirement together. For Eons' headquarters, he picked a slightly cramped three-story clock tower known as the Muster House that was built in 1853 just across the harbor from Boston. Until the 1970s,

The "lose weight" goal page carries an article on setting up a walking exercise program, a member's blog post complaining about exercising in the Florida heat, and an offer from the Curves International fitness chain for three free workouts with a trainer.

From the beginning, Taylor wanted to create

## THE PITCH

How social network startup Eons is wooing the over-50 crowd

**TO-DO LISTS** After members create a list of the top 10 things they want to do in retirement, Eons links together subscribers with similar goals.

**ONLINE OBITS** People over 50 are the top readers of newspaper obituaries. Eons compiled a database of 77 million obits. Members can search for obituaries, and can make contributions to them.

**BOOMER SEARCH** Eons' search engine, cRANKy, lists results based on studies of the types of inquiries people over 50 typically make online.

**LIFE MAP** As a legacy for children and grandchildren, Eons helps members create a time line that documents their life experiences.



when the Charlestown Navy Yard was closed, workers gathered here each week to collect paychecks.

For the first two weeks of the company's existence, Taylor worked alone at the Muster House. "An entrepreneur starts in a very lonely place," Taylor explains. "It's when you think you have a great idea and everyone around you thinks you're crazy, and you act on it." Now he has raised \$10 million and has more than 70 employees. Taylor has no office: He roams the halls, never without his trusty BlackBerry. When he needs to take

a sensitive call, he sits in the parking lot in his car.

Using technology to reshape connections is at the heart of Taylor's success with Monster.com is just as vital at Eons. The permanent obituary listings have potential to turn into a large business because they're based on adapting enduring ritual to the Digital Age: newspaper obits are paid places. They list the barest facts about a person and funeral details, then disappear into the recycling pile. Steve Cramer, former senior editor at the Poynter Institute for Media Studies and an Internet media pioneer, saw first-hand just how limited newspaper obits had become when his father died last year. "I found it offered much more interesting and significant by tapping some online stuff."

On Eons, obits don't die. And they have the potential to come alive with reminiscences and photos because members can compile information about themselves, and friends can add to obits. As a foundation, Eons created a database of deaths from 1937 using the Social Security Death Index to give members opportunity to find out who their friends passed away and create memorials for them.

Despite his lofty goals, Taylor won't have the same advantage of surprise he had when he started his online Monster job board for newspapers in 1994. Several

services already provide basic obituary listings for newspaper's Web sites. Legacy.com, which partners with hundreds of newspapers, like *The New York Times* to provide obituary family-authored obituaries, claims to post a day and 6 million unique visitors a month. Eons had fewer than 300,000 visitors in its first month. "I've seen quite a few competitors come and go," says Legacy's chief operating officer Hayes Ferguson. Still, with Taylor's record, it may not be long before Eons turns into a monster on its own. ■

**BusinessWeek** For a podcast with Eons' Jeff Taylor, go to [businessweek.com/go/06websmart](http://businessweek.com/go/06websmart)







BY ROBERT PARKER

# The Family that Put Napa on the Map

Chateau Montelena was little more than a ghost winery when lawyer Jim Barrett acquired the Napa Valley property in 1972. Just four years later, his Bordeaux trumped his French competitors in the now famous wine tasting—known as “the Judgment of Paris”—that showed Californians could compete with the French. Since then, Montelena’s cabernet sauvignon has been world-class, aging like a fine Bordeaux. Its zinfandel and riesling are excellent, too. ¶ Indeed, there is no better winemaker than the estate’s charismatic and down-to-earth son, Bo. Jim, supposedly retired, is always around the winery whenever I visit.

## 2003 Potter Valley Riesling

**90 points.** The medium-bodied Johannisberg Riesling, which is essentially dry (less than 1% residual sugar), reveals pleasant notes of pear mixed with apple skin and a hint of almond. It is a fresh, food-friendly white to enjoy over the next three to four years, perhaps even 18.

## 2002 Montelena Estate Zinfandel

**90 points.** This zin is blended with 1.5% syrah, 1.5% cabernet syrah, and 0.9% Viognier. It displays an elegant, ostentatious nose of red and black flowers, frying lard, and a hint of peaches. Lush, ripe, heady, and rich, this rustic effort will provide delicious drinking for the next five to seven years. \$28

## 2002 Montelena Estate Zinfandel

**90 points.** From dry-farmed, head-pruned vines planted in Calistoga, Calif., this estate’s dark ruby-hued wine offers a big, briary, peppery, loamy soil, and earth-scented effort. Enjoy this spicy, rich, full-bodied effort for the next three to four years. \$28

## 2003 Napa Valley Chardonnay

**90 points.** The wine reveals tropical fruit and butter characteristics, but perhaps not the depth and precision of the 2003. Regardless, it is a tasty, steely chardonnay with a little oak influence. \$38



Visit [www.eRobertParker.com](http://www.eRobertParker.com) for the Internet’s most active wine bulletin board, tens of thousands of tasting notes, or to order his recent book, *The World’s Greatest Wine Estates: A Modern Perspective*. You can also subscribe to Parker’s newsletter, *The Wine Advocate*. Request a sample copy at: *The Wine Advocate*, P.O. Box 311, Monkton, MD 21111.

## LIKE FATHER, LIKE SON

Jim and Bo, at Chateau Montelena

## 2003 Napa Valley Cabernet Sauvignon

**90 points.** This cab exhibits a dense ruby/purple color in addition to copious quantities of herb-tinged cassis fruit,

full-bodied and ripe tannin, and a soft, plump personality. It will be accessible young, yet will be able to age for 10 to 15 years. \$40

## 2002 Montelena Estate Cabernet Sauvignon

**95+ points.** With 14.4% alcohol, this is a relatively flamboyant effort. Its opaque purple color is followed by a gloriously pure nose of crème de cassis, licorice, earth, truffles, and flowers. Full-bodied, powerful, and rich, with high tannin as well as concentration, it is somewhat accessible now, but it will be even better after four to six years of aging in the bottle. The wine should drink beautifully for 25 to 30 years. \$95

## 2003 Montelena Estate Cabernet Sauvignon

**94 points.** This powerful, concentrated wine (14.3% alcohol) exhibits aromas of black currant jam, tar, smoke, and forest floor. While less flamboyant than the extroverted 2002, it’s an opulent effort—deep, chewy, pure, and well delineated. It is anticipated that this gem will mature sometime between 2010 and 2025, but it could go longer. \$105

Created from 96-100 are extraordinary; 90-95, excellent; 80-89, above average to very good. For more Parker picks, go to [businessweek.com/extras](http://businessweek.com/extras)





BY GENE G. MARCIAL

**MORE ROOMS AT INTERCONTINENTAL INNS, ESPECIALLY IN CHINA**

**VIASYS HEALTHCARE'S DISASTER GEAR IS IN GROWING DEMAND**

**PROMISING CANCER DRUGS AT SPECTRUM PHARMACEUTICALS**

## Intercontinental: Going Up

**I**NTERCONTINENTAL HOTELS GROUP (IHG), the chain with the most rooms worldwide, is getting even bigger and could be one of the best China plays for the 2008 Beijing Olympics. The British hotelier has 65 new properties in its pipeline, more than all U.S. innkeepers combined. In China, where it already has 57 hotels, IHG is headed for 50% growth by 2008. Of the 130,000 rooms planned, 40% are under construction. IHG plans to have 125 hotels in China by the end of 2008. China represents "tremendous opportunities," says Harry Curtis of JPMorgan Chase, which has done business with IHG. He rates the stock, now at 17.94, "overweight." He sees a gain of 20% to 50% in 12 to 18 months. And it's cheap, he notes, with a price-earnings ratio of 21. Marriott, Hilton, and Starwood have p-e ratios of 25 to 29. IHG has more than 3,650 hotels, including Holiday Inn and Crowne Plaza, with 540,000 guest rooms in 100 countries. IHG's bookings and prices for 2006's second half are up from a year ago, with "revenues per available room" expected to grow by 12% in Asia Pacific, 9% in the Americas, and 5% in the Middle East, says Curtis. He expects 2006 earnings of 74¢ a share and 96¢ in 2007. Anna Barnfather of Jefferies International in London sees a "positive outlook" and rates IHG a "buy." She upped her 2007 estimates after IHG delivered solid first half results, particularly in the U.S. The stock, she adds, "remains attractive relative to its U.S. peers."

### THE VIEW IS GOOD

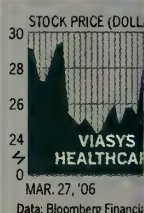


## Breathing Easier At Viasys Healthcare

**W**ITH HOMELAND SECURITY a top priority for federal, state, and local governments, the Street is scouting for companies that stand to benefit from disaster planning. Viasys Healthcare (VAS), which provides devices such as ventilators for people with respiratory ailments, is the top pick of Christopher Warren of Janney Montgomery Scott. He rates it a "buy," partly because of the rising demand for emergency gear, which he sees driving up sales by 25% annually, starting in 2007. California and New York, he says, are big potential markets. Spun off by Thermo Electron in 2001, Viasys has been growing through

acquisitions. "Our strong balance sheet has allowed us to do acquisitions and, at the same time, pay off debt," says CEO Randy Thurman, who expects Viasys to be debt-free by yearend 2006. Another bull, Arnold Kaufman of Brean Murray Carrett, expects Viasys to earn \$1.30 a share in 2006 and \$1.58 in 2007, vs. 97¢ in 2005. He figures the stock, now at 27.13, will rise to 35 in a year.

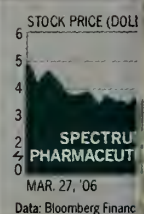
### STEADY INFLATION



## Spectrum Has A Rosy Glow

**W**HEN SPECTRUM PHARMACEUTICALS (SPPI) announced on Sept. 25 that results from the Phase 3 trials of its Satraplatin were "positive," shares bolted from 3.49 to 5 in a day—and are now at 5. Satraplatin is platinum-based chemotherapy taken orally for hormone-resistant prostate cancer. After the stock's jump, some warn there may be limited room to run. Not so, says Ren Benjamin of Rodman & Renshaw, who rates "outperform," with a 12-month target of 13. Based on early results and the timeline for accelerated approval, he says, Satraplatin may be launched in the U.S. in the third quarter of 2007. Assuming world sales of \$500 million a year, Benjamin figures Spectrum's royalties from partners GPC Biotech and Pharmion will total \$50 million by 2012. But he says the price doesn't yet reflect Spectrum's other products, such as Ozarelx for enlarged prostates. On Oct. 2, Spectrum announced that Phase 2 trials for Ozarelx were "significantly positive." The trials, held in Europe with partner Aeterna Zentaris, had "an excellent safety profile in treating benign prostatic hypertrophy," says CEO Rajesh Shrotriya. Megan Murphy of Lazard Capital Markets, who rates Spectrum a "buy," has a 12-month price target of

### SUDDEN SPURT



### BusinessWeek online

Gene Marcial's Inside Wall Street is posted at [businessweek.com/investor](http://businessweek.com/investor) at 5 p.m. EST on the magazine's publication day, usually Thursdays.

**Note:** Unless otherwise noted, neither the sources cited in Inside Wall Street nor firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.





### Here comes hope.

The first civilian helicopter rescue took place in 1945 off the coast of Connecticut.

"If a man is in need of rescue, an airplane can come in and throw flowers on him and that's about all. But a direct-lift aircraft could come in and save his life."

—Igor Sikorsky  
Which says it all.

$$FM = \frac{C_{T_0}}{\sqrt{2C_0}} \quad (\text{Hover efficiency ratio})$$

Tail pylon

Composite tail blade

### HUMS (Health & Usage Management System).

This system monitors the S-92 continuously, enabling it to operate at peak performance. Think of it as a helicopter with a health plan.

Engine

Auxiliary power unit

Composite rotor blade

### Passing the hat.

Igor Sikorsky always wore a fedora. Marine pilots would visit him, believing that if they donned his hat it would protect them from harm. Today his helicopter does exactly that.

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er.  
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ies per gallon.  
t challenging weather  
the S-92 can go 250  
les, search for two  
return to base with  
e. This is not even  
n-flight refueling,  
so available.

perature control  
ct Maintenance Costs).  
is up to 40% lower direct  
e costs per flight hour than  
um-lift helicopters.

or steps  
for more  
maintenance.  
ght  
ag.

as long as it's green.

ft paint with low to zero VOCs (volatile  
compounds) protects the environment and  
ees.

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Retractable  
landing gearThermal imaging  
system

Life raft

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fuel tanks

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There are almost no right or left-hand parts. Essentially all are universal for ease of replacement and reduced inventories.

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There's thermal imaging available that allows rescuers to find people they can't see.

### X2 Technology.™

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9 seats or 19 seats  
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## YOU DON'T HAVE TO UNDERSTAND EVERYTHING WE DO TO PROFIT FROM IT.

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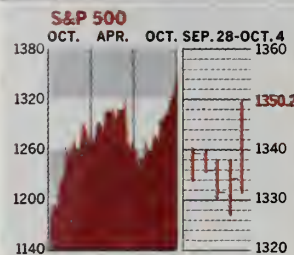


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## STOCKS



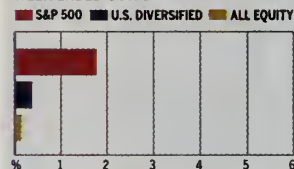
### COMMENTARY

After downbeat reports of moderate employment growth hung over stocks at the start of the week, the Dow Jones Industrial Average surged to eclipse its 2000 record on lower crude oil prices, improved consumer spending, and the prospect of lower interest rates. eBay and retail stocks were the big winners. Oil-field issues suffered.

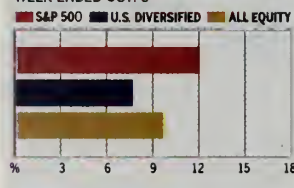
Data: Bloomberg Financial Markets, Reuters

## MUTUAL FUNDS

### 4-WEEK TOTAL RETURN



### 52-WEEK TOTAL RETURN



Data: Standard & Poor's

## U.S. MARKETS

|                       | OCT. 4   | WEEK | % CHANGE YEAR TO DATE | LAST 12 MONTHS |
|-----------------------|----------|------|-----------------------|----------------|
| S&P 500               | 1350.2   | 1.0  | 8.2                   | 11.2           |
| Dow Jones Industrials | 11,850.6 | 1.4  | 10.6                  | 13.5           |
| NASDAQ Composite      | 2291.0   | 1.2  | 3.9                   | 7.1            |
| S&P MidCap 400        | 760.0    | 0.2  | 3.0                   | 6.6            |
| S&P SmallCap 600      | 375.0    | -0.3 | 6.9                   | 7.7            |
| DJ Wilshire 5000      | 13,450.9 | 0.8  | 7.6                   | 10.6           |

## SECTORS

|                      |       |      | % CHANGE YEAR TO DATE | LAST 12 MONTHS |
|----------------------|-------|------|-----------------------|----------------|
| BusinessWeek 50*     | 762.1 | 1.0  | 2.7                   | 3.4            |
| BW Info Tech 100**   | 411.1 | 0.9  | 8.1                   | 12.4           |
| S&P/Citigroup Growth | 626.4 | 0.9  | 5.0                   | 7.9            |
| S&P/Citigroup Value  | 721.7 | 1.1  | 11.5                  | 14.6           |
| S&P Energy           | 399.9 | -2.4 | 7.3                   | 3.1            |
| S&P Financials       | 474.3 | 1.9  | 11.2                  | 21.1           |
| S&P REIT             | 186.9 | 1.5  | 22.2                  | 24.0           |
| S&P Transportation   | 262.8 | 2.6  | 5.2                   | 19.2           |
| S&P Utilities        | 175.1 | 0.2  | 9.6                   | 3.4            |
| GSTI Internet        | 179.7 | 3.0  | -12.4                 | 1.3            |
| PSE Technology       | 839.0 | 1.1  | 0.3                   | 3.0            |

\*Mar. 19, 1999=1000 \*\*Feb. 7, 2000=1000

## GLOBAL MARKETS

|                             | OCT. 4   | WEEK | % CHANGE YEAR TO DATE |
|-----------------------------|----------|------|-----------------------|
| S&P Euro Plus (U.S. Dollar) | 1795.2   | 0.2  | 18.1                  |
| London (FT-SE 100)          | 5966.5   | 0.6  | 6.1                   |
| Paris (CAC 40)              | 5256.6   | 0.3  | 11.1                  |
| Frankfurt (DAX)             | 6046.4   | 0.9  | 11.1                  |
| Tokyo (NIKKEI 225)          | 16,082.6 | 0.8  | -0.1                  |
| Hong Kong (Hang Seng)       | 17,629.2 | 0.6  | 18.1                  |
| Toronto (S&P/TSX Composite) | 11,618.1 | -1.1 | 3.1                   |
| Mexico City (IPC)           | 22,106.0 | 1.6  | 24.1                  |

## FUNDAMENTALS

|                                      | OCT. 3 | WEEK AGO |
|--------------------------------------|--------|----------|
| S&P 500 Dividend Yield               | 1.83%  | 1.82%    |
| S&P 500 P/E Ratio (Trailing 12 mos.) | 17.6   | 17.6     |
| S&P 500 P/E Ratio (Next 12 mos.)*    | 14.3   | 14.7     |
| First Call Earnings Surprise*        | 9.41%  | 4.83%    |

## TECHNICAL INDICATORS

|                                       | OCT. 3 | WEEK AGO |
|---------------------------------------|--------|----------|
| S&P 500 200-day average               | 1283.6 | 1281.8   |
| Stocks above 200-day average          | 55.0%  | 57.0%    |
| Options: Put/call ratio               | 0.95   | 0.87     |
| Insiders: Vickers NYSE Sell/buy ratio | 3.91   | 3.68     |

## BEST-PERFORMING GROUPS

|                          | LAST MONTH % | LAST 12 MONTHS % |
|--------------------------|--------------|------------------|
| Computer Stores          | 17.6         | 66.9             |
| Home Furnishings Rtlrs.  | 17.4         | 54.9             |
| Genl. Merchandise Chains | 16.5         | 48.2             |
| Auto Retail              | 14.7         | 41.6             |
| Casinos                  | 14.2         | 38.3             |

## WORST-PERFORMING GROUPS

|                         | LAST MONTH % | LAST 12 MONTHS %      |
|-------------------------|--------------|-----------------------|
| Coal                    | -20.7        | Homebuilding          |
| Gold Mining             | -20.3        | Internet Retailers    |
| Divsfd. Metals & Mining | -14.9        | Educational Services  |
| Oil & Gas Refining      | -14.0        | IT Consulting         |
| Agricultural Products   | -11.8        | Health-Care Suppliers |

## EQUITY FUND CATEGORIES

| 4-WEEK TOTAL RETURN | %     | 52-WEEK TOTAL RETURN  | %    |
|---------------------|-------|-----------------------|------|
| <b>LEADERS</b>      |       | <b>LEADERS</b>        |      |
| Financial           | 3.1   | Precious Metals       | 29.9 |
| Real Estate         | 2.1   | Real Estate           | 26.4 |
| Communications      | 1.9   | Latin America         | 25.8 |
| Large-cap Value     | 1.3   | Pacific/Asia ex-Japan | 21.4 |
| <b>LAGGARDS</b>     |       | <b>LAGGARDS</b>       |      |
| Precious Metals     | -14.6 | Natural Resources     | 0.7  |
| Natural Resources   | -11.8 | Health                | 2.3  |
| Latin America       | -3.1  | Small-cap Growth      | 2.9  |
| Japan               | -2.9  | Mid-cap Growth        | 4.0  |

## EQUITY FUNDS

| 4-WEEK TOTAL RETURN          | %     | 52-WEEK TOTAL RETURN       | %     |
|------------------------------|-------|----------------------------|-------|
| <b>LEADERS</b>               |       | <b>LEADERS</b>             |       |
| ProFds. Sh. Prc. Mtls. Inv.  | 23.3  | Oberweis China Opport.     | 57.4  |
| American Heritage            | 14.3  | U.S. Global Invs. Gold     | 49.1  |
| ProFds. Sh. Oil & Gas Inv.   | 10.7  | Midas                      | 44.7  |
| IShares D.J. U.S. Bkr. Dirs. | 8.6   | U.S. Gbl. Invs. Prc. Mnl.  | 44.0  |
| <b>LAGGARDS</b>              |       | <b>LAGGARDS</b>            |       |
| Ameritor Investment          | -50.0 | Ameritor Investment        | -90.9 |
| Rydex Precious Metals        | -21.2 | American Heritage Grth.    | -40.0 |
| DireXion Cmmnty Bull 2X      | -20.6 | Rydex Commodities H        | -25.7 |
| Midas                        | -20.0 | Merrill Lynch Rl. Invmt. C | -23.6 |

## INTEREST RATES

### KEY RATES

|                          | OCT. 4 | WEEK AGO |
|--------------------------|--------|----------|
| Money Market Funds       | 4.85%  | 4.84%    |
| 90-Day Treasury Bills    | 4.90   | 4.88     |
| 2-Year Treasury Notes    | 4.58   | 4.68     |
| 10-Year Treasury Notes   | 4.55   | 4.60     |
| 30-Year Treasury Bonds   | 4.71   | 4.74     |
| 30-Year Fixed Mortgage † | 6.12   | 6.05     |

## BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

|                       | 10-YR. BONO | 30-YR. BONO |
|-----------------------|-------------|-------------|
| General Obligations   | 3.79%       |             |
| Taxable Equivalent    | 5.41        |             |
| Insured Revenue Bonds | 3.85        |             |
| Taxable Equivalent    | 5.50        |             |

## THE WEEK AHEAD

**FEDERAL BUDGET** Wednesday, Oct. 11, 2 p.m. EDT » The federal government probably ran a surplus of \$38.5 billion in September, say economists polled by Action Economics. The August shortfall was \$64.6 billion.

**INTERNATIONAL TRADE** Thursday, Oct. 12, 8:30 a.m. EDT » The August foreign trade deficit is forecast to have narrowed to \$66 billion, after a July trade gap of \$68 billion.

**BEIGE BOOK** Thursday, Oct. 12, 2 p.m. EDT » The Federal Reserve releases its summary of economic conditions ahead of the two-day monetary policy meeting on Oct. 24 and 25. Every economist polled by Action Economics expects the Fed to keep interest rates at 5.25%.

**RETAIL SALES** Friday, Oct. 13, 8:30 a.m. EDT » Retail sales probably improved 0.3% during September, after drifting up 0.2%

in August. Minus autos, sales most likely fell 0.2%, after a 0.2% rise.

**EXPORT-IMPORT PRICES** Friday, Oct. 13, 8:30 a.m. EDT » September export prices probably climbed 0.3%, after a 0.4% gain in August. Import prices very likely plunged 1.2% on lower oil prices. August import prices rose 0.8%.

**BUSINESS INVENTORIES** Friday, Oct. 13, 10 a.m. EDT » In August inventories probably grew 0.4%, after a 0.6% gain in July.

The BusinessWeek production index held at 284.8 for the week Sept. 23, an 11% rise from previous year. Before calculating the four-week moving average index declined to 284.1.

## BusinessWeek on

For the BW50, more investment data, and the components of the production index visit [www.businessweek.com/extras](http://www.businessweek.com/extras)



# Company Index

Index gives the starting page for a story or feature with a  
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# Self-Portrait, Ego Included

**THE REAL DEAL** My Life in Business and Philanthropy

By Sandy Weill and Judah S. Kraushaar; Warner Business; 528pp; \$32

The most revealing photo in Sandy Weill's new memoir comes from 1984 and shows Weill, then president of American Express, with CEO James Robinson. Weill is beaming like the happiest man in the world, but what's most remarkable about the photo is the placement of his hands. One is wrapped

around Robinson's right arm, and the other grips his boss's left shoulder. Edgar Bergen never held Charlie McCarthy any tighter. This portrait of executive-as-would-be-ventriloquist conveys what always seemed to me to be Weill's essence: extraordinary energy and warmth coupled with overweening ambition and a compulsion for control.

*The Real Deal* fills in the outlines of Weill's story, from his Brooklyn childhood and formative years on Wall Street through the investment-banking scandals that marred his last years at Citigroup. Much of this will be familiar to readers of such books as Monica Langley's *Tearing Down the Walls*. But because Weill, who was 71 when he finally stepped down as CEO of Citigroup in 2003, was never either particularly forthcoming or articulate in his dealings with the press, this thick volume usefully adds his perspective to the record.

That said, readers will search in vain for passages of genuine candor or profound insight in this newest addition to the library of mogul memoirs. What makes *The Real Deal* intermittently fascinating nonetheless—at least for close students of Weill's career—is that his accounts of many of the great professional traumas that lined his path to the pinnacle are inadvertently unflattering to himself.

To give Weill his due, his success was hard-earned. The humble circumstances of his upbringing and the fact that he was Jewish put him at a marked disadvantage in starting out on Wall Street in the 1950s. Weill turned his outsider status to advantage by mastering the unglamorous ledger sheet and back-office fundamentals of business and in developing an exquisite feel for the unconventional business opportunity.

Weill built the upstart Shearson Loeb Rhoades from the broken pieces of haughty old-line brokerages unable to adapt to the Computer Age. In 1981, Weill sold Shearson to American Express, and many Wall Streeters assumed he soon would dislodge the seemingly soft, patrician Robinson as CEO. Instead, it was Weill who resigned in frustration after belatedly realizing that he would never run AmEx. In

1986, at age 53, he again started from scratch, acquiring rundown consumer finance company in Baltimore. Over the next decade, Weill transformed Commercial Credit through a series of bold acquisitions into Citigroup, the world's largest and most profitable financial institution.

Weill's accounts of the souring of his initially sympathetic relationships with Robinson and with John Reed, who left just a few years as co-CEO of Citigroup, are fairly judicious. But in writing about how he also fell out with the two headstrong and talented young executives who served as crown princes—Peter Cohen at Shearson and Jamie Dimon at Citigroup—Weill's self-justification

founder on one-sided notions of loyalty.

For example, during the negotiations to sell Shearson, Weill told Cohen that he would push hard for his appointment to AmEx's board of directors. When Robinson pushed back, Weill promptly caved but did not inform Cohen until days later, the end of a shared Friday afternoon ride home. As Weill got out, he blurted out the bad news and slammed the door in Cohen's face. Yet when Cohen on his own successfully lobbied Robinson for the board appointment, Weill was furious at his protégé's disloyalty. "Now I look completely foolish," Weill writes.

And Weill's quasi-paternal relationships with Dimon, now CEO of JPMorgan Chase, took a decisive turn for the worse, after

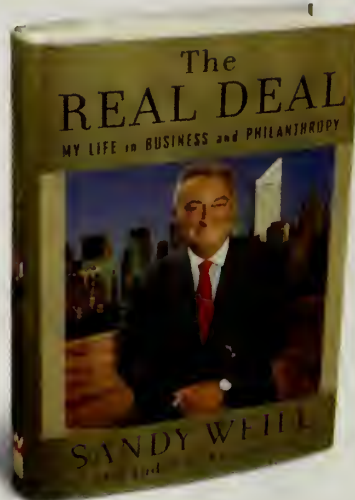
Citigroup hired Weill's daughter, Jessica Bibliowicz, in 1994. Bibliowicz, a mutual fund marketer several levels down from Dimon, disagreed with him about a marketing initiative. "At some point, I decided to step in on some of the discussions," Weill writes. "Coincidentally, I adopted a point of view that turned out to resemble Jessica's. Fancy that. When Dimon declined to vault Bibliowicz ahead of others into senior

**Sandy Weill seems oblivious to the baleful effects of his one-sided notion of loyalty**

Weill bristled at "a hurtful treatment of my daughter."

Weill is no Donald Trump, which is to say that he has not airbrushed all the flaws from his self-portrait in private. He repeatedly admits to insecurities and doubts. In the end, though, Weill comes across as a man whose ego is as towering as his ambition. That's him on the cover of *The Real Deal*, smiling the same smile as in 1984 but now standing happily alone before the backdrop of Manhattan's skyline.

—By Anthony E.





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## Better Teachers: A Lesson Plan

Good teachers matter. This may seem obvious to anyone who has a child in school or, for that matter, to anyone who has been a child in school. For a long time, though, researchers couldn't actually prove that teaching talent was important. But new research finally shows that teacher quality is a close cousin to student achievement: A great teacher can cram one-and-

half grades' worth of learning into a single year, while laggards are lucky to accomplish half that much. Parents and kids, it seems, have been right all along to care whether they were assigned to Mrs. Smith or Mr. Brown.

Yet, while we know now that better teachers are critical, flaws in the way that administrators select and retain them mean that schools don't always hire the best.

Many ingredients of good teaching are difficult to ascertain in advance—charisma and diligence come to mind—but research shows a teacher's own ability on standardized tests reliably predicts good performance in the classroom. You would think, then, that top-scoring teachers would be swimming in job offers, right? Not so, says Vanderbilt University professor Dale Ballou. High-scoring teaching applicants "do not fare better than others in the job market," he writes. "Indeed, remarkably, they do somewhat worse."

Even more surprising, given the national shortage of highly skilled math and science teachers, school administrators are more keen to hire education majors than applicants who have math or science degrees.

No one knows for sure why those who hire teachers routinely overlook top talent. Perhaps they wrongly think that the qualifications they shun make little difference for students. Also, administrators are probably naturally drawn to teachers who remind them of themselves.

But failing to recognize the qualities that make teachers truly effective (and to construct incentives to attract and retain more of these top performers) has serious consequences. For example, because schools don't always hire the best applicants, across-the-board salary increases cannot improve teacher quality much, and may even worsen it. That's because higher salaries draw more weak as well as strong applicants into teaching—applicants the current hiring system can't adequately screen. Unless administrators have incentives to hire the best teachers available, it's pointless to give them a larger group to choose from.

If public school hiring processes are bad, their compensation policies are worse. Most districts pay solely based on years of

experience and the presence of a master's degree, a formula that makes the Federal General Schedule—which governs pay for U.S. bureaucrats—look flexible. Study after study has shown that teachers with master's degrees are no better than those without. Job experience does matter, but only for the first few years, according to research by Hoover Institution's Eric A. Hanushek. A teacher with 15 years of experience is more effective, on average, than a teacher with five years of experience, but which one do you think is paid more?

This toxic combination of rigid pay and steep rewards for seniority causes average quality to decline rather than increase as teacher groups get older. Top performers often leave the

early for industries that reward their excellence. Mediocre teachers, on the other hand, are so overcompensated by seniority pay. And because they are paid more than their skills command elsewhere, these less-capable pedagogues seem to provide many years of ineffectual instruction.

So how can we separate the wheat from the chaff in the teaching profession? To make American schools competitive, we must reexamine seniority pay, the value of master's degrees, and the notion that a teacher can teach everything equally well—especially math and science—without appropriate preparation in the subject.

Our current education system is unlikely to accomplish this dramatic rethinking. Imagine

a moment, that American cars had been free in recent decades while Toyotas and Hondas sold at full price. We'd probably be driving Falcons and Corvairs today. Free public education is from a lack of competition in just this way. So while industries from aerospace to drugs have transformed themselves in order to compete, public schooling has stagnated.

School choice could spark the kind of reformation the industry needs by motivating administrators to hire the best and adopt new strategies to keep top teachers in the classroom. The lesson that good teachers matter should be taught, not as a theory, but as a practice. ■

Marie Gryphon is educational programs director at the Institute for Humane Studies and an adjunct scholar at the Cato Institute.

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a toxic  
combination  
of rigid pay  
and steep  
rewards for  
seniority**





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# Ideas **The Welch Way**

BY JACK AND SUZY WELCH

## It's Not About Empty Suits

**Does a leader have to have charisma?**

—Peter Wengryn, Mahwah, N.J.

You ask an age-old question that never seems to lose relevance. When we hear your question on the road, there's often some panic mixed in since the person asking has usually been accused of getting ahead on sheer personality or falling behind due to a lack of it. Indeed, almost everyone wonders at some point in his or her career how big a role charisma plays in success. So how big is it? In the short term, very. In the long term, very again—but not alone.

Now, we're obviously not talking here about "bad" charisma, exuded without brains, vision, and character. That trait is useless, and even dangerous. In business, wow personalities with less-than-wow minds are called empty suits for good reason. Too many of these individuals manage to ho-ho-ho their way to the top, even to the CEO's office, but most self-destruct after looking great for a couple of years while achieving little. On a larger scale, darkly charismatic leaders have the power to wreck lives and nations. And even though history warns us of their dangers, these types persistently emerge. Witness the recent hate speech by Venezuelan President Hugo Chávez at the U.N. He's a charismatic leader—too bad!

But good charismatic leaders are everywhere, too, leading with magnetism plus integrity and intelligence. And for them, charisma just makes the job a whole lot easier. Why? Because leaders have always had to energize their people. But in today's fiercely competitive global economy, they need to energize them more than ever. They have to pump up their people to tackle unscalable heights and make them understand why change is constantly necessary, passionately explaining what's in it for the company—and employees. All that can be done without charisma, using reasoning instead, but that approach takes a lot more of what global companies don't have anymore: time.

There are, of course, leaders who succeed without charisma. Alan Greenspan, former chairman of the Federal Reserve, has won legions of followers by the depth of his thinking. But much more commonly, you find smart, capable people stalled because they lack the innate ability to win hearts and minds. Yes, innate, because charisma, for better or worse, seems to be inborn. It can't really be trained into

**Charisma's  
hidden  
edge: It  
saves lucky  
leaders  
who have it  
so much  
time**

someone, and it certainly can't be faked for long. So who does that leave people without it? Definitely not off the leadership track—just in a slower, more challenging lar

**Why can't the U.S. car industry get it together?**

—Joseph Lahoud, Foxborough

The answer to your question could fill a book, but here's 30,000-foot take on the problem.

The U.S. automotive supply chain starts in coal mine moves to steel mills, and ends in the factories of Detroit. For a long time, this was a neat, airtight system. Every negotiating cycle, organized labor at each step asked for more, management eventually acquiesced, and costs were passed on to captive consumers.

Then foreign competition arrived, and American consumers responded exactly as you'd expect. Result: first coal and then steel went through bankruptcies and restructurings. The process was painful, but the industries have become competitive.

Meanwhile, the automotive industry has struggled. Yes, manufacturing has become more productive and the quality has improved, but major cost disadvantages remain, most notably the widely cited \$2,000-to-\$3,000 that each car carries to pay for retiree benefits.

What will happen? A slew of "Gotta Have It" new cars would help, but they'd just prolong the death-by-a-thousand cuts. No, our experience says that when an industry is in a downward cycle, its leaders almost never see how bad things could get. Bottoms-up revenue forecasts that are optimistic and the assumption that competitors will stay still while you improve are just two of the several "minor errors" that put off the draconian steps required.

Today, the car industry can counter that dynamic, but it will take enormous courage. For example, if it's four plants a company is considering closing, the number probably should be closer to eight. If it's two car models that might be eliminated, needs to think about four. If it's a pay freeze under consideration, the right move is probably more like a 30% pay cut.

Now, we recognize that it is a lot easier for appointed managers to announce such brutal changes than elected labor leaders push them through. What choice is there, though? Neither side created this problem: They inherited it. But if they don't accept joint ownership of the drastic solution, the past already tells the future. The fate of coal and steel industries awaits them. ■

*Jack and Suzy Welch look forward to answering your question about business, company, or career challenges. Please e-mail them at [thewelchway@businessweek.com](mailto:thewelchway@businessweek.com). For their weekly podcast, go to [www.businessweek.com/search/podcasting.htm](http://www.businessweek.com/search/podcasting.htm)*

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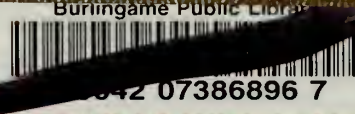


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A dark, textured interior, possibly a barn or a cave, with a window in the upper left showing a bright sun and a mountain range. In the foreground, there is a large pile of yellow straw. A white, curved object, possibly a pipe or a piece of equipment, is visible on the right side of the straw pile.

But is your IT  
system as reliable  
as you think?



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## Business Week

### What You Need to Know

at firms in the spotlight; Korean  
s; executive exodus; the  
be-Google deal; and more

### Views & Insights

#### The Real Worth of Web 2.0

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e, Google can afford it. That's  
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is new game

#### Talk with Steve Ballmer

Microsoft's CEO is awestruck by  
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#### Master of the Options Universe

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#### Why You're Paying More to Rent a Car

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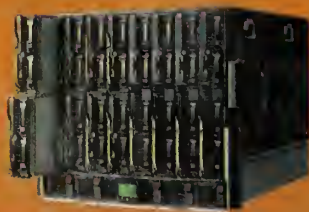
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On his way to work,  
Brian started to think  
about how changing  
applications could  
dramatically speed  
up product design.

Right after that, a  
server overheated  
and he spent the day  
shopping for fans.

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HP BladeSystem Enclosure with BL460c and BL480c server blades

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1. Based on internal HP testing of similarly configured rack and blade servers running identical tests.

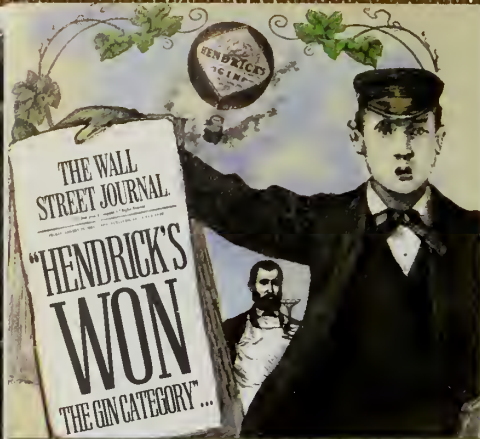


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## THE WALL STREET JOURNAL.

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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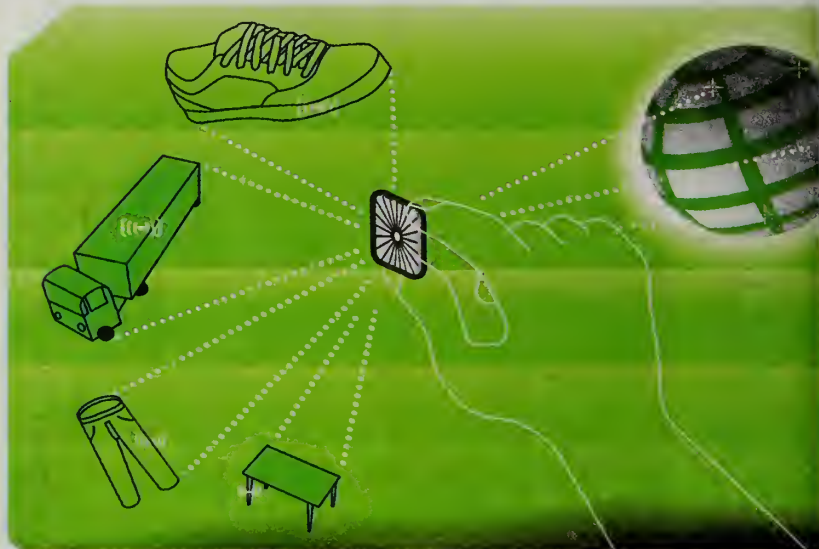
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## Tracking Takes Off

It wasn't too long ago that analysts were touting new technology to help companies like Wal-Mart and Target slice costs and monitor inventories by keeping tabs on products as they move from manufacturer to store shelf. But that method, known as **radio-frequency identification**, or RFID, was expensive and hard to put in place. This month's **CEO Guide to Technology** tells why that is changing and how companies are finding a slew of often unexpected ways to implement RFID. Dow Chemical CIO Dave Kepler explains how his company uses RFID and **global positioning system** (GPS) technology to reduce the risks of shipping hazardous chemicals. Learn why Ryder tapped tracking technology to help customers trim fuel costs and ensure trucks get to destinations on time. And **watch a video** of former Drug Enforcement Agency agent Aaron Graham as he describes efforts at Purdue Pharma to use tracking technology to fight drug dealers and keep pharmaceuticals safe. Asian countries, including China, Japan, and South Korea are hoping to **harness RFID's benefits** too, but the hurdles are especially high in China. To learn why and for more on location-aware technologies go to [www.businessweek.com/go/06location](http://www.businessweek.com/go/06location)

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# JP Front

"I apologize to Apple's shareholders and employees.... We will now work...to ensure that this never happens again."

—Apple CEO Steve Jobs, on the results of a company investigation that found instances of stock options backdating from 1997 to 2002.

BY DEBORAH STEAD

## D TRIPS

### On RV that runs on Wal-Mart

**WEEKLY BLOG** by Jim and Laura  
On Sept. 27, and from then until the blogosphere followed the couple on an RV journey from Nevada to Las Vegas, a trip that involved pulling in overnight at Wal-Mart lots, where RVs come to park. Every Wal-Mart the couple met and wrote seemed to love working for the company. Blog readers started asking questions: Are Laura and Jim real? Or is it all a public-relations stunt? The answer: yes. Jim is James Thresher, 58, a *Washington Post* photographer. St. Claire, 42, is a Treasury Dept. employee, freelance writer, and Wal-Mart shopper. The trip, she says, was the idea of the Washington (D.C.) couple's idea. She ran the blog by Working Families for Wal-



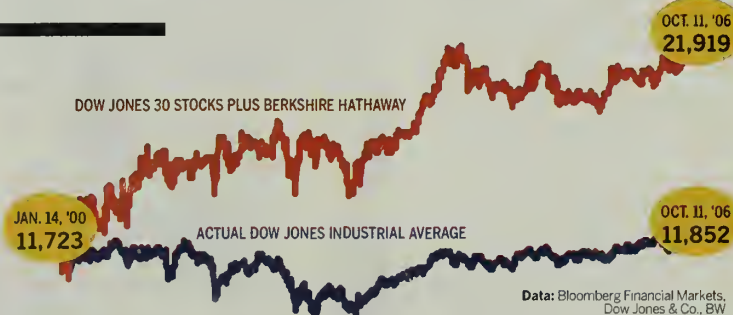
Mart, a group set up by PR firm **Edelman** last year that finds ardent shoppers like St. Claire to support the chain.

Edelman decided the group would sponsor the trip. It flew the couple to Las Vegas (where it decided the journey should start), provided a logo-emblazoned RV (above), and paid for gas and for St. Claire's blog entries. It also set up the blog site, Wal-Marting Across America, which didn't disclose the payments. Says Edelman Vice-President Kevin Sheridan: "They are regular folks

who approached us, and we thought it was a great opportunity." Thresher could not be reached for comment. But *Post* Executive Editor Leonard Downie Jr. says that Thresher had permission from his editor to take the Wal-Mart-sponsored trip, after an exchange Downie calls a "miscommunication." Thresher, he says, wound up violating "strict conflict-of-interest and freelance guidelines," was asked to remove his photos from the blog, and "will repay all the expenses incurred." —Pallavi Gogoi

## BIG PICTURE

**DOW IS BACK** in record territory. Even more impressive, Warren Buffett's Berkshire Hathaway recently hit an all-time high of \$100,000 a share. That's stratospheric. Imagine that Berkshire had joined the DJIA as a 31st member when the Dow last peaked, on Jan. 14, 2000. Berkshire is up 90% since then, and the DJIA gives more weight to higher-priced stocks. So from then until now,



the Dow would have risen about 10,000 points instead of about 130. "It would be a one-stock index," says John Prestbo, executive director of Dow Jones Indexes. "That would get us a lot of criticism." —Peter Coy





## ANTITERROR TECH

### MORE FINGERS ON THE JAM BUTTON?



**A BATTLE** is shaping up in a high-tech corner of the antiterror world. A Coral Springs (Fla.) entrepreneur has sued the **FCC**, contending that the agency is wrongly invoking the Communications Act of 1934 to continue to prevent local authorities from buying the same jamming devices used by the military and feds to cripple remote-control bombs, some of which are triggered by cell phones.

Howard Melamed, CEO of **CellAntenna**, which sells such jamming devices to the U.S. government, filed the suit in U.S. District Court in Florida. His argument: that the 2002 Homeland Security Act, which requires authorities to take all necessary steps to fight terrorism, takes precedence over the earlier law, which says only the feds can buy devices that interfere with the nation's airwaves. "It makes no sense why a bomb squad shouldn't be allowed to use jamming equipment," Melamed says. He adds he wouldn't mind if his rivals got all the business should he manage to overturn the law. "It would

be my pleasure," he says.

Would local police like access to jammers? "If federal law were to relax somehow, of course we would like to be able to purchase whatever is out there to help in the fight against terror," says detective Delrish Moss, a spokesman for the **Miami Police Dept.** But, he adds, "at a moment's notice, federal agencies are at our side to help with brain-and manpower as well as equipment."

The **Justice Dept.** wants the court to throw out the suit, claiming **CellAntenna** hasn't suffered economic damage and thus has no standing. The case is scheduled to be heard in December.

—Dean Foust

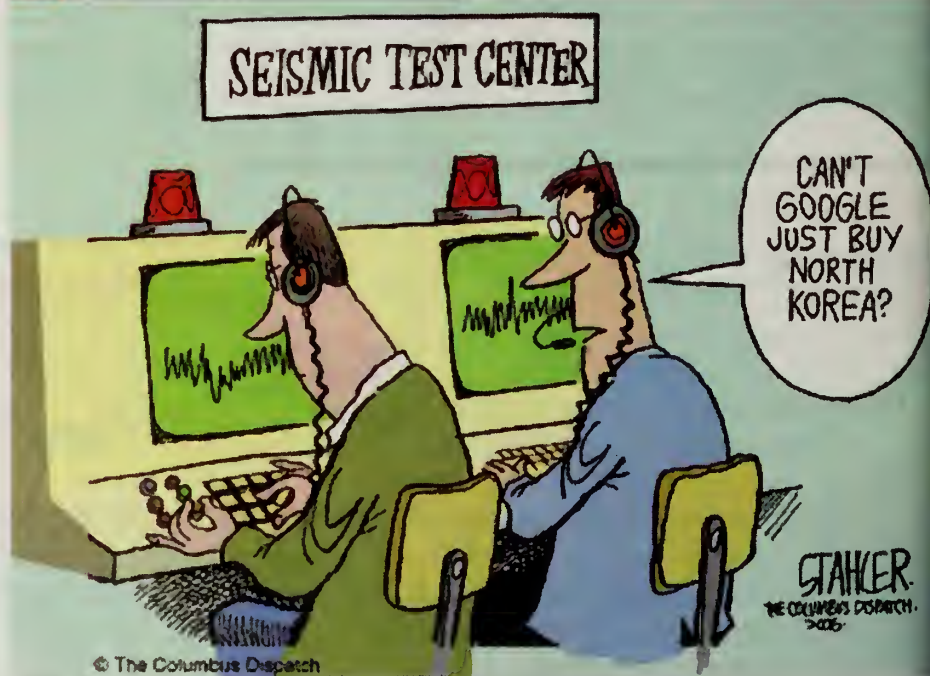


## SHANGHAI, AND STEP ON IT

**A FIXTURE** OF British life since 1948, London black cabs will roll off production lines in China starting in mid-2008. In a \$100 million joint venture, China's Zhejiang Geely Holding Group will make cabs in Shanghai to sell in Asia. **Manganese Bronze Holdings**, the cabs' British maker, retains all other marketing rights. In expanding manufacturing to China, Manganese expects to reduce costs, maintaining its taxi plant in Coventry while gaining access to cheaper parts from Geely's low-cost suppliers. The deal "will increase the appeal of our iconic vehicle" globally, says Manganese Chairman Tim Melville-Ross.

—Kerry Ca

## DRAWN & QUARTERED



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## GROUNDWORK



## BRINGING PROFITS BACK TO LIFE?

Come for the casket, stay for the consulting. That's the idea behind the "knowledge-based funeral service" now being floated in the industry by Wilson Beebe Jr., executive director of the New Jersey State Funeral Directors Assn. Beebe thinks mortuaries should go beyond "body-centered" services and offer survivors (often elderly) financial and home safety assessments for a fee. The aim is to prop up profit margins, which have fallen as the industry suffers from trends like a growing interest in cremation, which tends to be cheaper than burial.

Beebe's polls show most consumers like the plan, and he expects test runs at several New Jersey funeral homes in 2007. But the idea has drawn criticism in the industry. "What better way to assess how much money to get out of the family at the next funeral?" says Joshua Slocum of the Funeral Consumers Alliance, an industry watchdog group. *Funeral Monitor*, an industry publication, editorialized that the idea "smacks of inappropriate opportunism."

—Alex Halperin

## BENEFITS

## TAKING THE PULSE OF YOUR HEALTH PLAN

**IT'S OPEN** enrollment season at most companies, the annual rite of choosing the next year's health plan. And experts say 2007 will bring higher out-of-pocket costs along with higher premiums—an average of \$1,896 a year for individuals, up \$144 from 2006, according to benefits consulting firm **Towers Perrin**. What else will the typical 2007 health benefits package bring?

Prescription drug co-payments will rise at least \$5 on average, says **Watson Wyatt**, another benefits consulting firm. And while drugs that treat chronic conditions like asthma or diabetes may be exempt from the increase, specialty drugs won't. In fact, some plans are providing only 50% coverage for these meds. Someone being treated for leukemia

with **Novartis'** Gleevec, for example, will pay about \$2,600 for a month's supply. (There's no generic alternative.)

At the same time, companies are expanding dental coverage, in part because serious medical conditions like diabetes and heart disease can often be diagnosed by a dentist using fairly simple procedures. But dental benefits will cost employees 7% more, about \$288 a year for individuals, according to Towers Perrin.

Rising health costs are prompting companies to double-check who's on their rosters. Some employers are

imposing a monthly surcharge to cover a spouse or domestic partner who can't get benefits through his or her own employer. (**Ford Motor** has an annual surcharge of \$110 for the health plan and \$11 for dental benefits.) And employees seeking coverage for children or former spouses who might not be eligible for benefits likely will have to supply marriage certificates, tax returns, or tuition statements to make their case. Ford says such checking has eliminated 60,000 people from its health coverage since 2000.

—Lauren



## CLOSED BOOKS CAN'T HELP PEEKING

**BOOK EMBARGOES** are made to be broken. That seems to be the lesson of the past two weeks, during which *The New York Times* quoted from Bob Woodward's *State of Denial* and Carly Fiorina's memoir, *Tough Choices*, before their official sale dates. *BusinessWeek's* Elizabeth Woyke talked about embargoes with Will Weisser, associate publisher at Penguin's Portfolio imprint, which put out Fiorina's book.

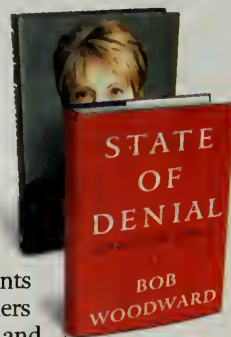
### Why embargo a book?

To protect whatever outlet has first coverage rights and to

give all book-sellers a fair shot. There are explicit agreements between publishers and booksellers, and the books arrive in boxes labeled: "Don't open until such-and-such date."

### There's speculation that Portfolio itself engineered the leak of *Tough Choices*.

People suspect that publishers play favorites, but we definitely didn't leak it. We really didn't want those news stories out before [Fiorina's appear-



ance on] 60 Minu

Did the broken embargo affect the deal with *Newsweek*, which has an excerpt online but not in the magazine?

I can't comment on any conversations with them or any-

that led to their decision. You can see the outcome and your own conclusions.

### Will publishers give up on embargoes?

After two leaks, back to back, I suspect publishers are looking at the practice pretty carefully to figure out how to prove the way we handle major newsbreaking books.

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## ANALYZE THIS

BY KERRY SULKOWICZ, M.D.

# No, No, I'm Not Ready to Go

**I'm a small-business founder with fear of the "R" word: I dread retirement even though, at 63, I realize it is approaching. Some days I think I'll survive the transition. Other days, I'm less certain. How can I retire at the right time, gracefully, and with a feeling of satisfaction that allows me to anticipate a new stage of my life?**

—Marcia Joslyn Sill, Seattle

**YOUR FEAR** is understandable and not unwarranted. True, many Americans slog through years of mind-numbing work inside the hierarchies of large corporations, counting the days until retirement liberates them from servitude. But as a founder, you're probably more like my chief executive clients, who have thrived on the excitement and relative freedom that work provides.

These CEOs take pride in "failing" retirement, involving themselves in boards and other businesses because work has been so intoxicating—and so familiar. For some people who love working, though, the terror of being without a job can lead to impulsive (and bad) decisions about how to fill the void, including making risky investments to make up for lost income, or rushing into love

relationships to ease the loss of self-esteem.

For others, retirement can provide just what you wish: a satisfying new stage of life. But it's not just a matter of finding the right time. You have to achieve the right state of mind.

What's needed to ensure a satisfying retirement? Beyond a comfortable nest egg, the ability to be alone with oneself, a real desire to spend more time at home (and with one's life partner, if you have one), and a realistically fulfilling set of activities to take on.

It seems that for you, retiring feels more like a loss than a gain right now. Have you asked yourself why you "have to" retire in a few years? Company retirement policy, failing health, diminished effectiveness, and a struggling business might be compelling reasons. Or are you merely being obedient to what society says you're "supposed" to do at a certain age? If you retire to satisfy such a convention, you well may be setting yourself up for anger and regret later on.



**RETIREMENT** is a tough transition for a business owner or entrepreneur, whose self-esteem can depend on self-reliance and constant stimulation. As a founder, you probably also have questions about your legacy, about whether your business survives. And don't underestimate the role of guilt

interfering with gratifying retirement: I know people who feel they're getting with murder when they're granted of freedom. They find their open calendars disorienting rather than inviting. Ultimately, the word reminds us

the "M" word, mortality. Since life doesn't end forever, working until the end, for some, feels like the next best thing.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executives on psychological aspects of business. Send questions at [analyzethis@businessweek.com](mailto:analyzethis@businessweek.com)

## QUESTION OF THE WEEK

For a sixth consecutive year, baseball's highest-paid team, the New York Yankees, blew it in the postseason. Should owner George Steinbrenner remake the team, or is Steinbrenner the basic problem? —Anthony Bianco

**"In this case, the boss's problem is that The Boss is the problem. After firing his general managers 20 times, Steinbrenner should realize that he has been misfiring. He should be the target, not the shooter."**

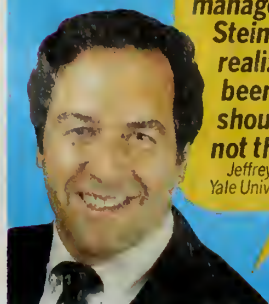
Jeffrey Sonnenfeld, associate dean, Yale University School of Management

**"Any halfway competent g.m. could have put together four or five winners with the \$1.2 billion he gave [General Manager] Brian Cashman to play with. If Steinbrenner's looking to clean house, he should start there."**

Stewart O'Nan, novelist and co-author of *Faithful*, about the Red Sox 2004 season

**"Maybe it was too easy at the end, and having Matsui and Sheffield back, as good as they are, changed the dynamic and momentum. We need pitching. What we don't need is to blame Joe Torre. Next year—and we mean it!"**

Mary Jo White, former federal prosecutor, now a partner at Debevoise & Plimpton

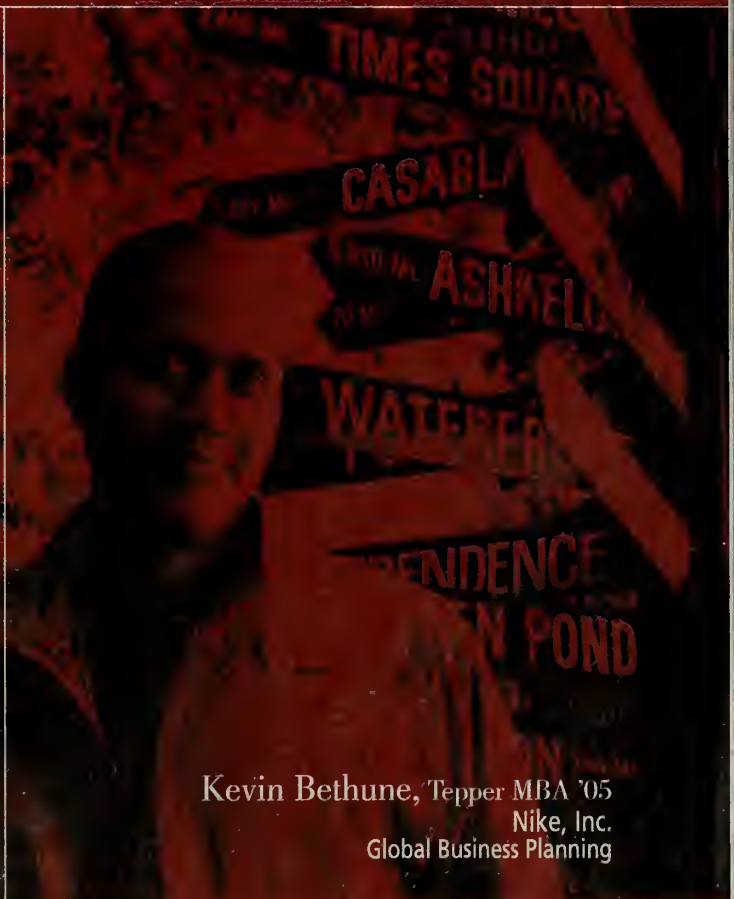


# We're Smaller So You're Bigger.

How do you go from nuclear engineering to Nike? Could two industries be more different? Just ask Kevin Bethune. He'd say a tight-knit community helps make anything possible. A community that is collaborative versus competitive, where people on the team know how to work as one. Where team and culture are the same thing. Having the work ethic to move mountains. For Kevin, it came from an MBA program that mirrored the business world. A B-school where the best comes from the collaboration of many. Where he knew every classmate. A place where Kevin was a person, not a number. He found such a community at the Tepper School of Business.

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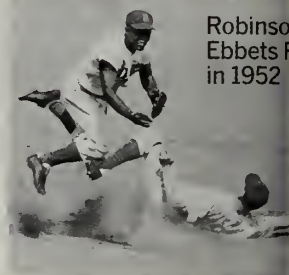


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**“In the mid-1870s... clubs dropped their black players... until 1947, when Jackie Robinson joined [the Dodgers].”**

—Ben Fisher  
Houston



Robinson Ebbets Field in 1952

**Editor's Note:** For a discussion of our Oct. 2 Cover Story, “Click fraud,” turn to Feedback, page 104.

### ROBINSON WASN'T THE FIRST BLACK BIG-LEAGUER

“THE RACIAL GAP in the grandstands” (Sports Biz, Oct. 2) states that Jackie Robinson was the first black big-league ballplayer, in 1947.

But the origins of Major League Baseball are considered to date back to 1869, when the National Association of Base Ball Players began allowing professional play. At that time, blacks were on the teams. The (white) owners struck a gentlemen's agreement in the mid-1870s to bar nonwhite players from professional baseball. The exception was that American Indians were allowed to play. Clubs dropped their black players gradually and did not sign youngsters. It wasn't until the 1890s that there were no teams with black players.

Some owners resisted the ban. Still, it held until 1947, when Jackie Robinson joined a major league team, the Brooklyn Dodgers, after a 55-year gap.

—Ben Fisher  
Houston

### THE NURSING SHORTAGE: SEXIST STEREOTYPES DON'T HELP

“WHAT'S REALLY propping up the omy?” (Cover Story, Sept. 25) implies the solutions to some of our problems health care can be solved by technology. However, technology is not the answer. We're facing a severe shortage of nurses that will only get worse as population ages.

Part of the problem lies in the fact nursing is still thought of as a “female profession.” The media constantly force this image with stereotypes, helps to keep some 50% of the population from considering nursing as a career.

Your cover image is a good example. The illustration [a play on WWI's I the Riveter] is dated, sexist, and does not present an accurate picture of nursing today. This type of media coverage will further the health-care crisis.

—Carlo Parker, RN,  
Boca Raton

### THE CASE AGAINST 20-70-10 PERFORMANCE REVIEWS

I BELIEVE THE 20-70-10 performance system (“The case for 20-70-10,” WelchWay, Oct. 2) to be without merit. It worked for a Fortune 500 company

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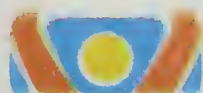


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## ReadersReport

tried it, and just a few years later they put the sword to this experiment. Rather than relying on an individual supervisor's judgment and experience to rate workers, the 20-70-10 performance system pushes the job of rating employees onto a committee, thus disenfranchising the employee-supervisor relationship.

When annual review time comes, supervisors are left with the onerous task of telling the true top performers they are not going to be promoted because of some nebulous reason no one understands. Worse still is how the system creates a whole group of managers who have no real idea how their individual subordinates are performing.

After four years, my company quietly decided to pull the plug on this disaster. However, the damage had already been done. The last time I checked on the company—a long-standing icon of American industry—it had been forced to merge with a French company to have any hope of competing with its rivals.

—Geoffrey M. Lenart  
Ventura, Calif.

### TO MAKE RISKY INVESTMENTS SAFER, TRY A MUTUAL FUND

I WAS DISAPPOINTED to see no mention of mutual funds in Aaron Pressman's "Risky bets that may not pay" (Personal Finance, Oct. 2). The investments he cites—timber investment management organizations, rare coins, a portfolio of real properties—make little or no sense for the average investor.

Yet a diversified mutual fund of natural resources and/or real estate investment trusts would be a smart complement to the usual portfolio of stocks and bonds. Certainly, "a 10% timber allocation to a typical stock and bond portfolio" is off the wall. But 5% in timber within a 5% to 10% of total portfolio allocation to a natural resources mutual fund makes perfect sense.

—James Stehr  
Alameda, Calif.

### BRAINSTORMING: THE LOOSER PEOPLE ARE, THE BETTER

"THE TRUTH ABOUT brainstorming" (Inside Innovation, Sept. 25) did not directly address what I consider to be the most significant problem with getting the most out of brainstorming: loosening up the participants so that they feel free to make silly or even outrageous comments in the hopes of stimulating innovative ideas.

An example: The session once used on an aircraft carrier to determine how to

avoid damage while in port during a hurricane. A comical idea to line up the members and have them blow against the ship to keep it away from the evolved into placing the aircraft on dock and using the plane's backwash to hold the ship off the dock.

In my experience it isn't easy to get people to loosen up to conduct this kind of brainstorming.

—Don J. ...  
Rochester

### CORRECTIONS & CLARIFICATIONS

In "Potations from Chairman Mao" (Global Business, Oct. 9), the name of Grace Vineyard's founder was spelled incorrectly. It is Chan Chun Keung.

"Battle for the index investor" (Personal Finance, Oct. 9) reported that the expense ratio on the PowerShares' FTSE RAFI 100 Portfolio is 0.76%. However, the company is charging only 0.60% for expenses through April, 2007.

"Getting fit glued to the tube" (Sports Business, Oct. 16) incorrectly put the Denver Nuggets in the National Football League. The team is in the National Basketball Assn.

The Business Week (Oct. 16) stated that Russian aluminum giants Rusal and Suz merged on Oct. 4. In fact, the merger was not announced until Oct. 9.

A story about Citigroup, "Cleaned up but falling behind" (Oct. 16), should have specified that Alcoa CEO Alain J.P. Belda is lead director at Citi, not just a board member, and that the company's stock has been stagnating for five years, not three.

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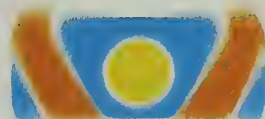
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Rosuvastatin is contraindicated in patients with active liver disease or with unexplained persistent elevations of serum transaminases (see WARNINGS, Liver Enzymes). **Pregnancy and Lactation:** Atherosclerosis is a chronic process and discontinuation of lipid-lowering drugs during pregnancy should have little impact on the outcome of long-term therapy of primary hypercholesterolemia. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they may cause fetal harm when administered to pregnant women. Therefore, HMG-CoA reductase inhibitors are contraindicated during pregnancy and in nursing mothers. ROSUVASTATIN SHOULD BE ADMINISTERED TO WOMEN OF CHILD-BEARING AGE ONLY WHEN SUCH PATIENTS ARE HIGHLY UNLIKELY TO CONCEIVE AND HAVE BEEN INFORMED OF THE POTENTIAL HAZARDS. If the patient becomes pregnant while taking this drug, therapy should be discontinued immediately and the patient apprised of the potential hazard to the fetus. **WARNINGS:** **Liver Enzymes:** HMG-CoA reductase inhibitors, like some other lipid-lowering therapies, have been associated with biochemical abnormalities of liver function. The incidence of persistent elevations (>3 times the upper limit of normal [ULN]) occurring on 2 or more consecutive occasions in serum transaminases in fixed dose studies was 0.4, 0.0, and 0.1% in patients who received rosuvastatin 5, 10, 20, and 40 mg, respectively. In most cases, the elevations were transient and resolved or improved on continued therapy or after a brief interruption in therapy. There were two cases of jaundice, for which a relationship to rosuvastatin therapy could not be determined, which resolved after discontinuation of therapy. There were no cases of liver failure or irreversible liver disease in these trials. It is recommended that liver function tests be performed before and at 12 weeks following both the initiation of therapy and any elevation of dose, and periodically (e.g., semiannually) thereafter. Liver enzyme changes generally occur in the first 3 months of treatment with rosuvastatin. Patients who develop increased transaminase levels should be monitored until the abnormalities have resolved. Should an increase in ALT or AST of >3 times ULN persist, reduction of dose or withdrawal of rosuvastatin is recommended. Rosuvastatin should be used with caution in patients who consume substantial quantities of alcohol and/or have a history of liver disease (see CLINICAL PHARMACOLOGY, Special Populations, Hepatic Insufficiency). Active liver disease or unexplained persistent transaminase elevations are contraindications to the use of rosuvastatin (see CONTRAINDICATIONS). **Myopathy/Rhabdomyolysis:** Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with rosuvastatin and with other drugs in this class. Uncomplicated myalgia has been reported in rosuvastatin-treated patients (see ADVERSE REACTIONS). Creatine kinase (CK) elevations (>10 times upper limit of normal) occurred in 0.2% to 0.4% of patients taking rosuvastatin at doses up to 40 mg in clinical studies. Treatment-related myopathy, defined as muscle aches or muscle weakness in conjunction with increases in CK values >10 times upper limit of normal, was reported in up to 0.1% of patients taking rosuvastatin doses of up to 40 mg in clinical studies. In clinical trials, the incidence of myopathy and rhabdomyolysis increased at doses of rosuvastatin above the recommended dosage range (5 to 40 mg). In postmarketing experience, effects on skeletal muscle, e.g., unexplained myalgia, myopathy, and, rarely, rhabdomyolysis have been reported in patients treated with HMG-CoA reductase inhibitors including rosuvastatin. As with other HMG-CoA reductase inhibitors, reports of rhabdomyolysis with rosuvastatin are rare, but higher at the highest marketed dose (40 mg). Factors that may predispose patients to myopathy with HMG-CoA reductase inhibitors include advanced age (>65 years), hypothyroidism, and renal insufficiency. Consequently, 1. Rosuvastatin should be prescribed with caution in patients with predisposing factors for myopathy, such as, renal impairment (see DOSAGE AND ADMINISTRATION), advanced age, and inadequately treated hypothyroidism. 2. Patients should be advised to promptly report unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. Rosuvastatin therapy should be discontinued if markedly elevated CK levels occur or myopathy is diagnosed or suspected. 3. The 40 mg dose of rosuvastatin is reserved only for those patients who have not achieved their LDL-C goal utilizing the 20 mg dose of rosuvastatin once daily (see DOSAGE AND ADMINISTRATION). 4. The risk of myopathy during treatment with rosuvastatin may be increased with concurrent administration of other lipid-lowering therapies or cyclosporine (see CLINICAL PHARMACOLOGY, Drug Interactions, PRECAUTIONS, Drug Interactions, and DOSAGE AND ADMINISTRATION). The benefit of further alterations in lipid levels by the combined use of rosuvastatin with fibrates or niacin should be carefully weighed against the potential risks of this combination. Combination therapy with rosuvastatin and gemfibrozil should generally be avoided. (see DOSAGE AND ADMINISTRATION and PRECAUTIONS, Drug Interactions). 5. The risk of myopathy during treatment with rosuvastatin may be increased in circumstances which increase rosuvastatin drug levels (see CLINICAL PHARMACOLOGY, Special Populations, Race and Renal Insufficiency, and PRECAUTIONS, General). 6. Rosuvastatin therapy should also be temporarily withheld in any patient with an acute, serious condition suggestive of myopathy or predisposing to the development of renal failure secondary to rhabdomyolysis (e.g., sepsis, hypotension, dehydration, major surgery, trauma, severe malnutrition, endocrine, and electrolyte disorders, or uncontrolled seizures). **PRECAUTIONS:** **General:** Before instituting therapy with rosuvastatin, an attempt should be made to control hypercholesterolemia with appropriate diet and exercise, weight reduction in obese patients, and treatment of underlying medical problems (see INDICATIONS AND USAGE). Administration of rosuvastatin 20 mg to patients with severe renal impairment ( $CL_{CR} < 30$  mL/min/1.73 m<sup>2</sup>) resulted in a 3-fold increase in plasma concentrations of rosuvastatin compared with healthy volunteers (see WARNINGS, Myopathy/Rhabdomyolysis and DOSAGE AND ADMINISTRATION). The result of a large pharmacokinetic study conducted in the US demonstrated an approximate 2-fold elevation in median exposure in Asian subjects (having either Filipino, Chinese, Japanese, Korean, Vietnamese or Asian-Indian origin) compared with a Caucasian control group. This increase should be considered when making rosuvastatin dosing decisions for Asian patients. (see WARNINGS, Myopathy/Rhabdomyolysis; CLINICAL PHARMACOLOGY, Special Populations, Race, and DOSAGE AND ADMINISTRATION). **Information for Patients:** Patients should be advised to report promptly unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. When taking rosuvastatin with an aluminum and magnesium hydroxide combination antacid, the antacid should be taken at least 2 hours after rosuvastatin administration (see CLINICAL PHARMACOLOGY, Drug Interactions). **Laboratory Tests:** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg, when compared to lower doses of rosuvastatin or comparator studies, though it was generally transient and was not associated with worsening renal function. Although the clinical significance of this finding is unknown, a dose reduction should be considered for patients on rosuvastatin 40 mg therapy with unexplained persistent proteinuria during routine urinalysis testing. **Drug Interactions:** **Cyclosporine:** When rosuvastatin 10 mg was coadministered with cyclosporine in cardiac transplant patients, rosuvastatin mean  $C_{max}$  and mean AUC were increased 11-fold and 7-fold, respectively, compared with healthy volunteers. These increases are considered to be clinically significant and require special consideration in the dosing of rosuvastatin to patients taking concomitant cyclosporine (see WARNINGS, Myopathy/Rhabdomyolysis,

and DOSAGE AND ADMINISTRATION). **Warfarin:** Coadministration of rosuvastatin to patients on stable warfarin therapy resulted in clinically significant rises in INR (>4, baseline 2-3). In patients taking coumatin anticoagulants and rosuvastatin concomitantly, INR should be determined before starting rosuvastatin and frequently enough during early therapy to ensure that no significant alteration of INR occurs. Once a stable INR time has been documented, INR can be monitored at the intervals usually recommended for patients on coumatin anticoagulants. If the dose of rosuvastatin is changed, the same procedure should be repeated. Rosuvastatin therapy has not been associated with bleeding or with changes in INR in patients not taking anticoagulants. **Gemfibrozil:** Coadministration of a single rosuvastatin dose to healthy volunteers on gemfibrozil (600 mg twice daily) resulted in a 2.2- and 1.9-fold, respectively, increase in mean  $C_{max}$  and mean AUC of rosuvastatin (see DOSAGE AND ADMINISTRATION). **Endocrine Function:** Although clinical studies have shown that rosuvastatin alone does not reduce basal plasma cortisol concentration or impair adrenal reserve, caution should be exercised if any HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered concomitantly with drugs that may decrease the levels or activity of endogenous steroid hormones such as ketconazole, spironolactone, and cimetidine. **CNS Toxicity:** CNS vascular lesions, characterized by perivascular hemorrhages, edema, and mononuclear cell infiltration of perivascular spaces, have been observed in dogs treated with several other members of this drug class. A chemically similar drug in this class produced dose-dependent optic nerve degeneration (Wallenberg degeneration of retinogeniculate fibers) in dogs, at a dose that produced plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose. Edema, hemorrhage, and partial necrosis in the interstitium of the choroid plexus was observed in a female dog sacrificed moribund at day 24 at 90 mg/kg/day by oral gavage (systemic exposures 100 times the human exposure at 40 mg/day based on AUC comparisons). Corneal opacity was seen in dogs treated for 52 weeks at 6 mg/kg/day by oral gavage (systemic exposures 20 times the human exposure at 40 mg/day based on AUC comparisons). Cataracts were seen in dogs treated for 12 weeks by oral gavage at 30 mg/kg/day (systemic exposures 60 times the human exposure at 40 mg/day based on AUC comparisons). Retinal dysplasia and retinal loss were seen in dogs treated for 4 weeks by oral gavage at 90 mg/kg/day (systemic exposures 100 times the human exposure at 40 mg/day based on AUC). Doses  $\leq 30$  mg/kg/day (systemic exposures  $\leq 60$  times the human exposure at 40 mg/day based on AUC comparisons) following treatment up to one year, did not reveal retinal findings. **Carcinogenesis, Mutagenesis, Impairment of Fertility:** In a 104-week carcinogenicity study in rats at dose levels of 2, 20, 60, or 80 mg/kg/day by oral gavage, the incidence of uterine stromal polyps was significantly increased in females at

patients in placebo-controlled clinical studies of rosuvastatin are shown in Table 1. In patients due to adverse events in these studies of up to 12 weeks duration occurred in 3% on rosuvastatin and 5% on placebo.

Table 1. Adverse Events in Placebo-Controlled Studies

| Adverse event           | Rosuvastatin<br>N=744 | Placebo<br>N=382 |
|-------------------------|-----------------------|------------------|
| Pharyngitis             | 9.0                   | 7.6              |
| Headache                | 5.5                   | 5.0              |
| Diarrhea                | 3.4                   | 2.9              |
| Osteopenia              | 3.4                   | 3.1              |
| Nausea                  | 3.4                   | 3.1              |
| Myalgia                 | 2.8                   | 1.3              |
| Asthenia                | 2.7                   | 2.6              |
| Back pain               | 2.6                   | 2.4              |
| Flu syndrome            | 2.3                   | 1.8              |
| Urinary tract infection | 2.3                   | 1.6              |
| Rhinitis                | 2.2                   | 2.1              |
| Sinusitis               | 2.0                   | 1.8              |

In addition, the following adverse events were reported, regardless of causality as  $\geq 1\%$  of 10,275 patients treated with rosuvastatin in clinical studies. The events in italics in  $\geq 2\%$  of these patients. **Body as a Whole:** Abdominal pain, accidental injury, chest pain, pain, pelvic pain, and neck pain. **Cardiovascular System:** Hypertension, angiodysplasia, and palpitation. **Digestive System:** Constipation, gastroenteritis, vomiting, periodontal abscess, and gastritis. **Endocrine:** Diabetes mellitus. **Hemic and Systemic:** Anemia and ecchymosis. **Metabolic and Nutritional Disorders:** **Phosphorus:** Hypophosphatemia. **Systemic:** Arthritis, arthralgia, and pathological fracture. **Nervous System:** Insomnia, hyperreflexia, paresthesia, depression, anxiety, vertigo, and asthenia. **Respiratory System:** Bronchitis, cough increased, dyspnea, pneumonia, and asthma. **Appendages:** Rash and pruritus. **Laboratory Abnormalities:** In the rosuvastatin program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose (80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg compared to lower doses of rosuvastatin or comparator studies, though it was generally transient and was not associated with worsening renal function. (see PRECAUTIONS, Laboratory Abnormalities). Other abnormal laboratory values reported were elevated creatine phosphokinase, aspartate aminotransferase, glutamyl transpeptidase, alkaline phosphatase, bilirubin, a function abnormalities. Other adverse events reported less frequently than 1% in the clinical study program, regardless of causality assessment, included arrhythmia, hepatic sensitivity reactions (i.e., face edema, thrombocytopenia, leukopenia, vesiculobullous urticaria, and angioedema), kidney failure, syncope, myasthenia, myositis, pancreatitis, sensitivity reaction, myopathy, and rhabdomyolysis. **Postmarketing Experience:** To the events reported above, as with other drugs in this class, the following event was reported during post-marketing experience with CRESTOR, regardless of causality as a very rare case of jaundice. **OVERDOSEAGE:** There is no specific treatment in overdose. In the event of overdose, the patient should be treated symptomatically and measures instituted as required. Hemodialysis does not significantly enhance clearance of rosuvastatin. **DOSAGE AND ADMINISTRATION:** The patient should be placed on cholesterol-lowering diet before receiving CRESTOR and should continue on this diet. CRESTOR can be administered as a single dose at any time of day, with or without food. **Heterozygous Familial and Nonfamilial (Fredrickson Type IIa and IIb):** The dose range for is 5 to 40 mg once daily. Therapy with CRESTOR should be individualized according to therapy and response. The usual recommended starting dose of CRESTOR is 10 mg. However, initiation of therapy with 5 mg once daily should be considered for patients receiving aggressive LDL-C reductions, who have predisposing factors for myopathy, and as noted special populations such as patients taking cyclosporine, Asian patients, and patients with renal insufficiency (see CLINICAL PHARMACOLOGY, Race, and Renal Insufficiency, Interactions). For patients with marked hypercholesterolemia (LDL-C  $\geq 190$  mg/dL) and lipid targets, a 20 mg starting dose may be considered. After initiation and/or upon CRESTOR, lipid levels should be analyzed within 2 to 4 weeks and dosage adjusted. The 40 mg dose of CRESTOR is reserved only for those patients who have not achieved their LDL-C goal utilizing the 20 mg dose of CRESTOR once daily (see WARNINGS, Myopathy/Rhabdomyolysis). When initiating statin therapy or switching from another statin to appropriate CRESTOR starting dose should first be utilized, and only then titrated to the patient's individualized goal of therapy. **Homozygous Familial Hypercholesterolemia:** The recommended starting dose of CRESTOR is 20 mg once daily with homozogous FH. The maximum recommended daily dose is 40 mg. CRESTOR should be used in patients as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) if such treatments are unavailable. Response to therapy should be estimated from pre-therapy levels. **Dosage in Asian Patients:** Initiation of CRESTOR therapy with 5 mg should be considered for Asian patients. The potential for increased systemic exposures in Asian patients is relevant when considering escalation of dose in cases where hypercholesterolemia is not adequately controlled at doses of 5, 10, or 20 mg once daily. (see WARNINGS, Myopathy/Rhabdomyolysis; CLINICAL PHARMACOLOGY, Special Populations, Race, and PRECAUTIONS, General). **Dosage in Patients Taking Cyclosporine:** In patients taking cyclosporine, therapy should be limited to CRESTOR 5 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Concomitant Lowering Therapy:** The effect of CRESTOR on LDL-C and total-C may be enhanced in combination with a bile acid binding resin. If CRESTOR is used in combination with gemfibrozil, the dose of CRESTOR should be limited to 10 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Dosage in Patients With Renal Insufficiency:** No modification of dosage is necessary for patients with moderate renal insufficiency. For patients with severe renal impairment ( $CL_{CR} < 30$  mL/min/1.73 m<sup>2</sup>) not on hemodialysis, dosing of CRESTOR should be started at 5 mg once daily, expected 10 mg once daily (see PRECAUTIONS, General, and CLINICAL PHARMACOLOGY, Special Populations, Renal Insufficiency).

**NOTE:** This summary provides important information about CRESTOR. For more information please ask your doctor or health care professional about the full Prescribing Information discuss it with them.

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Wilmington, DE 19850  
By: IPR Pharmaceuticals, Inc.  
Carolina, NC 03984  
PCC 630302 30043-01 31028-00 Rev 08/05 242155



80 mg/kg/day at systemic exposure 20 times the human exposure at 40 mg/day based on AUC. Increased incidence of polyps was not seen at lower doses. In a 107-week carcinogenicity study in mice given 10, 60, 200 mg/kg/day by oral gavage, an increased incidence of hepatocellular adenoma/carcinoma was observed at 200 mg/kg/day at systemic exposures 20 times human exposure at 40 mg/day based on AUC. An increased incidence of hepatocellular tumors was not seen at lower doses. Rosuvastatin was not mutagenic or clastogenic with or without metabolic activation in the Ames test with *Salmonella typhimurium* and *Escherichia coli*, the mouse lymphoma assay, and the chromosomal aberration assay in Chinese hamster lung cells. Rosuvastatin was negative in the *in vivo* mouse micronucleus test. In rat fertility studies with oral gavage doses of 5, 15, 50 mg/kg/day, males were treated for 9 weeks prior to and throughout mating and females were treated 2 weeks prior to mating and throughout mating until gestation day 7. No adverse effect on fertility was observed at 50 mg/kg/day (systemic exposures up to 10 times human exposure at 40 mg/day based on AUC comparisons). In testicles of dogs treated with rosuvastatin at 30 mg/kg/day for one month, spermatid giant cells were seen. Spermatid giant cells were observed in monkeys after 6-month treatment at 30 mg/kg/day in addition to vacuolation of seminiferous tubular epithelium. Exposures in the dog were 20 times and in the monkey 10 times human exposure at 40 mg/day based on body surface area comparisons. Similar findings have been seen with other drugs in this class. **Pregnancy:** **Pregnancy Category X:** See CONTRAINDICATIONS. Rosuvastatin may cause fetal harm when administered to a pregnant woman. Rosuvastatin is contraindicated in women who are or may become pregnant. Safety in pregnant women has not been established. There are no adequate and well-controlled studies of rosuvastatin in pregnant women. Rosuvastatin crosses the placenta and is found in fetal tissue and amniotic fluid at 3% and 20%, respectively, of the maternal plasma concentration following a single 25 mg/kg oral gavage dose on gestation day 16 in rats. A higher fetal tissue distribution (25% maternal plasma concentration) was observed in rabbits after a single oral gavage dose of 1 mg/kg on gestation day 18. If this drug is administered to a woman with reproductive potential, the patient should be apprised of the potential hazard to a fetus. In female rats given oral gavage doses of 5, 15, 50 mg/kg/day rosuvastatin before mating and continuing through day 7 postcoitus results in decreased fetal body weight (female pups) and delayed ossification at the high dose (systemic exposures 10 times human exposure at 40 mg/day based on AUC comparisons). In pregnant rats given oral gavage doses of 2, 20, 50 mg/kg/day from gestation day 7 through lactation day 21 (weaning), decreased pup survival occurred in groups given 50 mg/kg/day, systemic exposures  $\geq 12$  times human exposure at 40 mg/day based on body surface area comparisons. In pregnant rabbits given oral gavage doses of 0.3, 1, 3 mg/kg/day from gestation day 6 to lactation day 18 (weaning), exposures equivalent to human exposure at 40 mg/day based on body surface area comparisons, decreased fetal viability and maternal mortality was observed. Rosuvastatin was not teratogenic in rats at  $\leq 25$  mg/kg/day or in rabbits  $\leq 3$  mg/kg/day (systemic exposures equivalent to human exposure at 40 mg/day based on AUC or body surface comparison, respectively). **Nursing Mothers:** It is not known whether rosuvastatin is excreted in human milk. Studies in lactating rats have demonstrated that rosuvastatin is secreted into breast milk at levels 3 times higher than that obtained in the plasma following oral gavage dosing. Because many drugs are excreted in human milk and because of the potential for serious adverse reactions in nursing infants from rosuvastatin, a decision should be made whether to discontinue nursing or administration of rosuvastatin taking into account the importance of the drug to the lactating woman. **Pediatric Use:** The safety and effectiveness in pediatric patients have not been established. Treatment experience with rosuvastatin in a pediatric population is limited to 8 patients with homozogous FH. None of these patients was below 8 years of age. **Geriatric Use:** Of the 10,275 patients in clinical studies with rosuvastatin, 3,159 (31%) were 65 years and older, and 698 (6.8%) were 75 years and older. The overall frequency of adverse events and types of adverse events were similar in patients above and below 65 years of age. (see WARNINGS, Myopathy/Rhabdomyolysis). The efficacy of rosuvastatin in the geriatric population ( $\geq 65$  years of age) was comparable to the efficacy observed in the non-elderly. **ADVERSE REACTIONS:** Rosuvastatin is generally well tolerated. Adverse reactions have usually been mild and transient. In clinical studies of 10,275 patients, 3.7% were discontinued due to adverse experiences attributable to rosuvastatin. The most frequent adverse events thought to be related to rosuvastatin were myalgia, constipation, asthenia, abdominal pain, and nausea. **Clinical Adverse Experiences:** Adverse experiences, regardless of causality assessment, reported in  $\geq 2\%$  of





# Beware the High-Tech Ballot

By the standards of Washington newspeak, the Help America Vote Act (HAVA) is in a class by itself. For more than 200 years, the U.S. ran elections quietly, efficiently, and mostly honestly. But since passage of the 2002 law, the simple act of casting a ballot has become the stuff of high drama. There's a lesson here about the use and abuse of technology.

HAVA was a response to the 2000 electoral deadlock in Florida. But based on a misdiagnosis of the problem. The inescapable fact in Florida was the outcome was a tie. George W. Bush's official margin over Al Gore was 537 votes, or 0.005% of the votes cast, and since any method of casting or counting ballots has error, that difference was just noise to be split. But images of butterfly ballots and hanging chads convinced politicians and the public that the problem was bad technology and that the solution lay in changing how the nation votes. HAVA allocated more than \$3 billion to pay for high-tech systems, and vendors rushed to fill the demand. Although there was money for training, "states were forced to go out and buy equipment," says Jim Adler, president of VoteHere, a Bellevue, Wash., firm that develops ballot auditing systems.

THE RESULT HAS BEEN CHAOS in one election after another, worse likely in store for November. Much attention has been given to the fact that electronic voting machines, especially those made by Diebold Election Systems, may be vulnerable to attacks by hackers. And Princeton University computer scientist Edward Felten recently showed that the digital lock that protects Diebold machines from tampering can be opened with keys easily purchased on the Internet. While there have been no reports of attacks on machines in actual use, the risks Felten and others have pointed out are serious and highlight the danger of rushing to embrace untested technology. Failures, both human and electronic, are already affecting the ability of people to vote, as happened in Maryland's Sept. 12 primary. All was confusion at a local elementary school because county officials had failed to send out the access cards voters use to cast ballots on the Diebold AccuVote-TS machines. I was lucky; I had to cast a provisional paper ballot, supplies of which were quickly exhausted.

In the turmoil, I barely noticed the new electronic poll book also from Diebold, that replaced an old but utterly reliable paper check-in system. Aviel Rubin, a Johns Hopkins



## Untested technology and poor training can lead to disaster

while mature technology, applied judiciously, can reduce human error, untested technology foisted on poorly trained workers is an invitation to disaster.

It's important to keep such examples in mind as we try new technologies in other areas. Electronic databases of medical records could be of enormous benefit. And a planned electronic surveillance system on the Mexican border could be more effective and less intrusive than a physical fence. But if we rush into new systems without adequate regard for reliability, security, and privacy, the consequences could be far worse than the voting mess. ■

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# Surviving Business Disasters

Hurricanes, earthquakes, power failures, fires: disasters like these can strike at any time, often with notice. The costs in human lives and property damage are well known and plainly visible to anyone who watches the nightly news. But another, less obvious, cost exists, one that rarely makes its way into the news reports: the interruption and potential demise of business operations.

**T**he effects can be catastrophic. According to studies by the Institute for Business & Home Safety, a Tampa, Fla., research group, 25 percent of all companies that are shut down due to disaster never reopen. For small businesses, the figure may be as high as 50 percent. In New Orleans, following Hurricane Katrina, entire city blocks were closed permanently.

## Surviving a disaster

What determines whether a business survives a disaster? More than anything, it's the degree of preparation. A panel of information technology experts convened by the IT publication Datamation two years after 9/11 revealed that a key distinction among the companies that survived the Twin Towers' collapse and those that did not was the differences in the quality of their disaster-recovery planning.

Panelists cited the example of two banks. One, American Express Bank in New York, was back in operation within a day of the terrorist attacks, because its emergency operations site and data backups lay across town. Another bank, though, had established its disaster recovery site only two blocks away, in an area that proved inaccessible for months. The other bank had still not recovered two years later.

Even small firms that took such simple steps as backing up data remotely and photographing and documenting their key assets to expedite claims processing were able to return to operation within a short time, while hundreds of similar, but less prepared firms went out of business.

## Preparing for disaster

In light of obvious advantages like these, why don't more companies prepare for disasters ahead of time? There are two main reasons: a lack of time and a lack of knowledge. Preparations can be both costly and time-consuming, and most small firms – and even many larger ones – lack the tools that would allow them to properly assess and address their exposure to disaster.

Zurich, one of the world's leading insurance-based financial service providers, assists firms in matters like these with business continuity products and resources, including tools that aid in identifying and mitigating risk, and developing a business continuity and recovery plan. Best of all, according to Zurich, preparing a basic plan using these tools can be

done inexpensively and completed most in a reasonable timeframe.

## Responding quickly

Of course, even the best business continuity plans cannot ward off effects of some disasters, leaving insurance payments to serve as the sole bridge back to financial solvency. Such was the case in New Orleans following Hurricane Katrina, where insured losses topped \$50

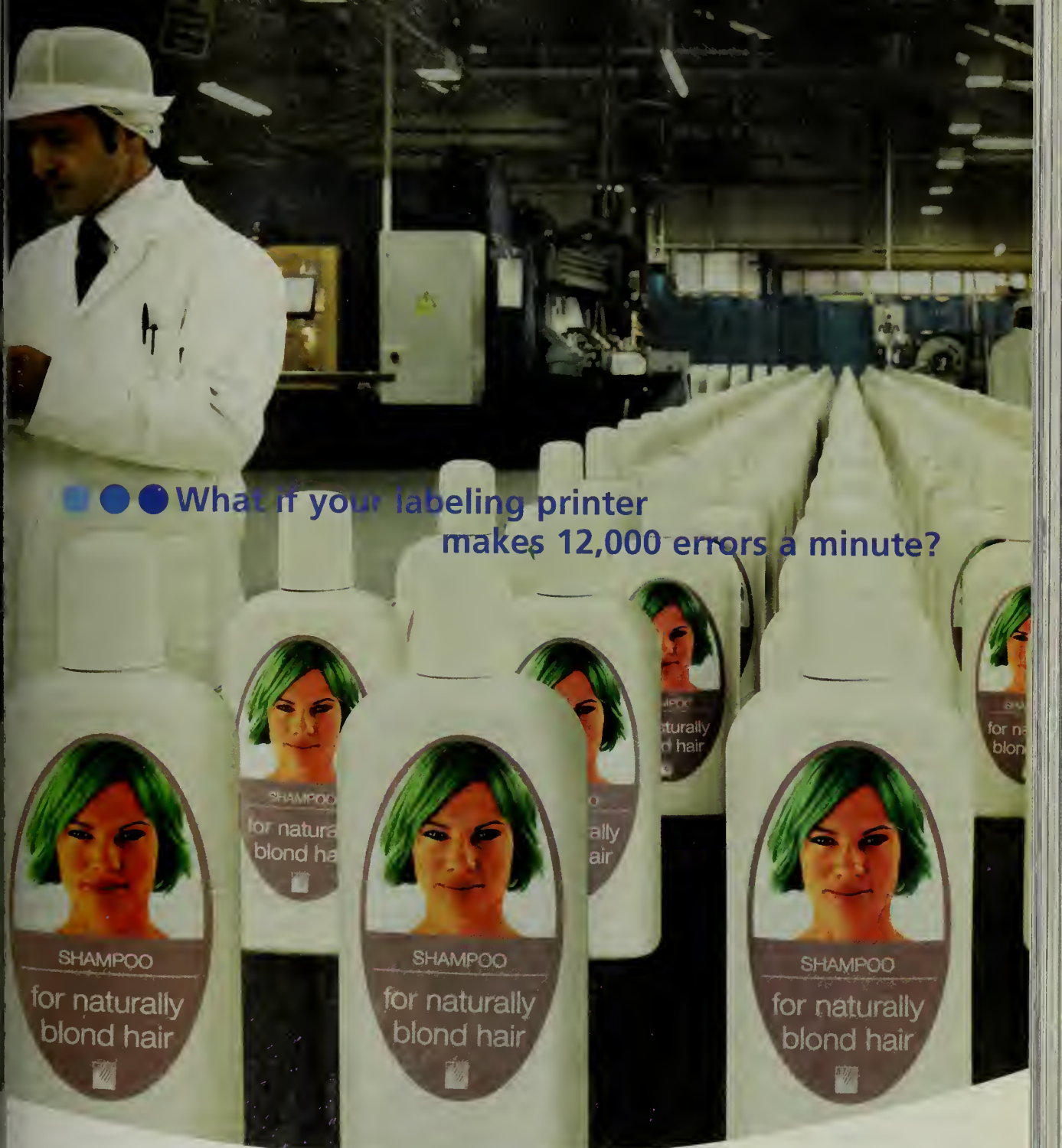
million. In such circumstances, timeliness of the insurer's response can be as critical to business survival as a well-thought-out recovery plan. The Ernest N. Morial Exhibition Hall Authority, a governing body for the city's pivotal tourism and convention business,

certainly found this to be true. Warren Reuther, the Authority's president, recalls that the city's internationally renowned convention center had been badly damaged, not just by Katrina's floodwaters but also by the center's days of use as shelter for desperate, homeless citizens who nowhere else to go.

Fortunately, Zurich was there to help. "Zurich came down in the second week, brought a check for \$5 million and told us to get going in making the necessary repairs," said Reuther. The convention center is the "main factory that we have the city of New Orleans," Reuther points out. "It is the engine that runs the city." And, thanks to Zurich, he explains, "it's open again."

What determines whether a business survives a disaster? More than anything, it's the degree of preparation.





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## Reworking the Ad Mix

The average chief marketing officer has a notoriously short tenure, so the lofty reputation of Wachovia CMO Jim Garrity is perhaps best evidenced how neatly the word “longstanding” fits in front of his title. Garrity is prototypically steady senior-level executive, tanned and low-key. He speaks softly, in sentences studded with the jargon of both the marketing and the

worlds. (His first job was at IBM.) Garrity, who oversees a nine-figure marketing budget, sometimes sounds like a man who never met a data point he didn't like. This is because he is trying to invent a system that quantifies return on investment to better justify and target Wachovia's ad spending. Garrity and those like him are quietly reworking the advertising mix of the American corporation.

Garrity is a careful man in a job that requires a tightrope walk through a windstorm. (Most of us can afford to miss goals by a percentage point or two; if a CMO does, it can wreck a company's year.) As such, he does not go into much detail about how Wachovia rigorously tests its marketing spending. He does say his findings have led the company to blend old and new approaches. He loves Web advertising for its “demonstrable” results but says traditional plays, such as Wachovia's pro golf event and conferences, are also star performers. (Wachovia's investment banking division has significantly cut ad spending in favor of events.) He has made no secret of his feeling that broadcast TV is “becoming less valuable,” saying as much at a recent panel I moderated. That he was seated next to a top NBC executive added a tinge of tension to the proceedings.

**MONEY IS SEXY. BANKS AREN'T.** People don't buttonhole you at cocktail parties to wax poetic about their financial institution. And, as Garrity points out, consumers have a hard time differentiating one bank from another. (How many distinctive bank branch offices have you seen?) But despite the low-valence bond between customers and banks, Garrity notes, it's still hard to pry people away from established banking relationships. And bank advertising does not easily lend itself to crazed creative approaches of the sort that Burger

King has undertaken in order to lodge a brand in consumer craniums. Still, Wachovia has done well for itself via a long series of acquisitions, and its stock price is up over in the past year. But that strategy has been maxed out, s

### Wachovia's Garrity blends old and new



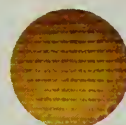
Garrity. The company will now have to new customers one at a time. This will Garrity's marketing skills, and data, to test. Luckily, the banking business is both personal and data-intensive: Wachovia has direct relationships with its roughly million household and business customers. Compare this with a beer company, which reaches customers only through distributors.

Garrity isn't trashing the old playbook. Wachovia still spends plenty on broadcast TV—\$53.8 million last year, according to TV Media Intelligence, or just under 30% of its total spending. (Garrity's model suggests that sports and news are the best ways to reach Wachovia's audience on television.) But it has cut back: in 2004, Wachovia spent \$66.8 million, or 37% of its budget, on broadcast. Garrity says that spending will drop again in 2006. His company's research, like any that churns through reams of data from various inputs, is treated as a work in progress. “If we had wholesale bet the ranch” on its findings this year, he says, “we would have allocated 40% [of the budget] significantly differently.” Nevertheless, Wachovia's choices offer an early snapshot of the next-generation mass-marketing but

less broadcast TV, with that spending tightly focused; more cable TV, which is better at targeting niche audiences; and much more online advertising. Even if a bunch of Jim Garrity were running things, changes in how Big Business spends ad dollars wouldn't come fast. But if just a few follow Garrity's lead, change will come nonetheless. ■

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Thailand's electronics and electrical industries have come a long way since the early focus on integrated circuit packaging and low-end assembly

to become a diverse mix of multinational, OEM contract and end-product manufacturers. The industry created one half million jobs last year alone, and saw E&E exports reach a staggering US\$36 billion.

The supportive role played by Thailand's business friendly government, which promotes free trade and liberal economic policies, and the benefits derived from locating at one of the country's many industrial estates have truly paved the way to success for some of the world's largest E&E manufacturers. Small and medium sized enterprises too share in the prosperity that surrounds Thailand's electronics and ICT market, and benefit alongside the largest of players.

Investors in Thailand can enjoy a seamless process from production to delivery using the Customs Department's new electronic container and seal systems that makes use of radio frequency identification technology (RFID), expediting the export of goods through one of Thailand's deep-sea ports or its new Suvarnabhumi International Airport. With a 100,000 square meter customs free zone and an annual capacity of 1.26 million tons the new airport is the largest in Asia and will greatly reduce the logistics costs of Thailand's many manufacturers.

Through a continued and determined focus on excellence and efficiency, Thailand emerged in 2005 as the world leader in the production of hard disk drives(HDD) and stands among the leaders in exporting electronic integrated circuits, air-conditioners

and televisions, cameras and washing machines and many other consumer electronics. HDD manufacturers employ over 100,000 people and supply over 30% of the global demand, contributing to a staggering US\$11.9 billion worth of HDD and computer parts exports in 2005. Add to that success the roughly US\$ 5.5 billion in integrated circuits exported last year and the success of Thailand's investment policies is evident.

With Thailand beginning its transition towards becoming a knowledge-based society the electronics sector and associated

### HDD Manufacturers in Thailand

**Seagate**  
Samut Prakarn  
and Nakorn Ratcahsima

**Fujitsu**  
Pathumthani

**Western Digital**  
Pathumthani  
and Ayutthaya

**Hitachi Global Storage**  
Prachinburi

advanced skills and technologies will only continue to grow in importance. In order to keep pace of these changes, the Board of Investment earlier this year increased the incentives offered for investments in the electronics sector, adding to an already attractive package of tax and other assistance measures.

Whether your business is consumer electronics, automotive electronics or one of the many parts and components companies, and others, that support the vibrant electronics industry, Thailand offers you a rich



and growing environment for investment. To assist you with any questions, with gaining promotion privileges or facilitating your start-up in Thailand, the Board of Investment is the one-stop investment service center meeting all your needs. We look forward to hearing from you soon.

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JAMES C. COOPER

# The Job Reports Aren't Doing Their Job

Why the Labor Dept.'s payroll numbers are confusing the markets

**U.S. ECONOMY** The first Friday of every month is the day Wall Streeters know to batten down the hatches. That's usually when the Labor Dept.'s employment report hits the newswires. The latest storm came when September's data, released on Oct. 6, sent the bond market reeling. The problem is, it's getting increasingly difficult to know what

crucial compilation of research is actually saying about the health of labor markets and the economy from month to month.

For example, the report's headline measure, payroll jobs, rose a surprisingly scant 51,000 from August, the weakest showing since Hurricane Katrina. You'd think that would have sparked a big bond-market rally. Expectations the Federal Reserve would be cutting interest rates. However, the Labor Dept.'s other measure, nonfarm payrolls, contained in the same report and taken from a survey of households, showed a solid gain of 271,000, and unemployment fell to a five-year low of 4.6%. Adding to the confusion, Labor revised the August payroll gain up by an unusually large 60,000 workers, bringing what had been a modest 128,000 increase into a strong 188,000 advance. It also made a more striking revision: In the 12 months through March, it said, about 100,000 more payroll jobs had been created than first reported. So what should we believe? Did the report indicate strength or weakness?

Although on balance the numbers imply the economy is doing some in recent months, the data argue that the labor markets are a lot stronger than the paltry rise in September payrolls suggests. That means the bond market's knee-jerk sell-off, which pushed long-term rates up sharply, was the right reaction. As long as the market is solid, consumer spending will remain well-supported, and the threat of a housing-led economic downturn is much less worrisome. For the markets, contrary to recent expectations, the jobs data mean the Fed is unlikely to start cutting rates any time soon.

**PROBLEM WITH THE JOB DATA** right now is the declining credibility of the Labor Dept.'s initial reading of payroll numbers, which it derives from a survey of businesses. That's because the agency's revisions are quite large. Consider the pattern this year: The initially reported numbers showed sizable monthly gains of 196,000, on average, from January to May, which then slowed sharply to just 109,000 in June from May to August. But the revised readings showed a more modest easing, from 160,000 per month

to 136,000. Amid concern this year about just how much the economy is cooling, recent initial employment reports appear to have exaggerated the slowdown.

Economists have long considered payroll numbers the preferred measure of job growth compared with data from the household survey. However, veteran Wall Street economist Edward E. Yardeni, now at Oak Associates Ltd. in Akron, Ohio, wonders why the markets still pay so much attention to the first-reported payroll data, and called them "useless" in a recent client briefing.

**MAYBE THAT'S A BIT STRONG**, but Yardeni does make an interesting point in light of the Labor Dept.'s annual benchmark revision, which was also reported on Oct. 6. Each year Labor goes back to more detailed state employment records and corrects its estimates, using

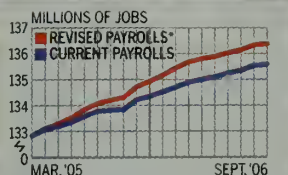
March as its benchmark month. This year its preliminary results show the level of payrolls in March, 2006, was actually 810,000 jobs higher than the figure now on the books. If that stands, it would be an exceptionally large revision by historical standards. There will be further refinements before the final estimate,

which will be incorporated with full monthly revisions into the January, 2007, job report.

The result of this restatement is far from trivial (chart). The new benchmark says payrolls have grown 2.8 million from March, 2005, to March, 2006, not 2 million. That means job growth has averaged 68,000 per month more than current data show, which means 237,000 more jobs per month, not 169,000. The bottom line: The job market has been stronger than anyone thought, and it continues to offer solid support to the economy.

The payroll revisions clear up other inconsistencies in recent data clouding the view of current economic

## WHAT THE NEW JOB DATA MIGHT LOOK LIKE



\*ASSUMES BENCHMARK REVISION IS DISTRIBUTED EQUALLY FROM MARCH, 2005, TO MARCH, 2006, WITH NO CHANGE IN CURRENT DATA  
Data: Bureau of Labor Statistics, Global Insight Inc., BusinessWeek



trends. For one, they suggest that the strong employment gains evident in the Labor Dept.'s survey of households over the past year (an average gain of 201,000 jobs per month) is the more accurate reading of the labor market's health, not the payroll survey's finding of an average rise of just 148,000. After the new benchmark is incorporated, these two surveys will be telling similar stories, at least through March. From March to March, the household survey shows job growth at 2.2%, and with the revisions, the payroll jobs figure rises to a parallel 2.1%, instead of only 1.5% before.

**EVEN MORE IMPORTANT**, the most recent payroll surveys, for April through September, may still be understating actual job growth. For one thing, job gains in the household survey since March continue to run ahead of the payroll data. For another, a keenly watched private-sector measure, compiled jointly by Automatic Data Processing, a large private-sector processor of payroll data, and economic consultant Macroeconomic Advisers, is also outpacing the government's figures. ADP builds its numbers from employment records in an effort to foreshadow the government's payroll figures.

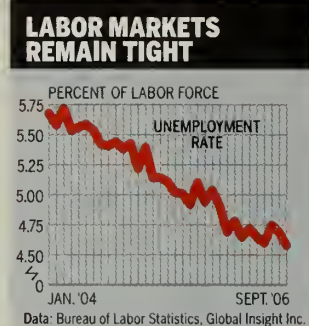
The Labor Dept.'s revisions give new credibility to ADP's monthly tracking. ADP showed faster growth in payrolls from March to March than the Labor Dept. did originally, and from April to September, it shows payroll gains currently averaging 159,000 per month, much higher than Labor's 118,000.

The government's revised data also validate this year's robust growth in labor income and tax receipts. Through

August, wage and salary income is up 7.7% from a year ago, far greater than inflation, and the Treasury Dept. says personal tax revenues for the fiscal year 2006 ended in September were up 12.6%. This is all consistent with continued resilience in consumer spending despite record gasoline prices this summer. In the coming

months, as the drop in pump prices dampens overall inflation, the impact of strong income gains will be apparent in spending.

More payroll jobs explain why the labor markets remain tight as seen in September's low unemployment rate (chart). The changing composition of the workforce, which has



resulted in slower labor force growth, is also keeping labor markets tight. Several years ago, payroll gains of about 150,000 per month were required to hold the jobless rate steady. Now economists put that number at 130, or lower, meaning this year's employment growth, while slower than in 2005, is still fast enough to keep the job rate down and to keep upward pressure on hourly pay.

The key conclusion: Economic growth, while a bit slower, is much more durable than recent payroll data suggest. If you are worried the economy is heading for a serious slump anytime soon, think again. ■

## CONSUMER SPENDING

# Saving at the Pump, Buying at the Mall

**FALLING GASOLINE** prices are freeing up more cash for consumers to buy other goods and services. Early evidence has already emerged in some September figures, but the biggest impact is still to come. What's more, heading into the winter, heating bills should be smaller than last year's.

During September, retail gasoline prices averaged \$2.54 per gallon. That was down not only from August but also from September, 2005, when the average was \$2.91. Based on this year's lower price and a small uptick in demand for gas, consumers shelled out about \$3.7 billion less for gasoline this September vs. the

same month a year ago, according to Wachovia Corp. economists Gina Martin and Jason Schenker. With chain-store sales coming in above expectations, it appears consumers used that money to shop.

Buyers should find themselves with even more cash to spend in October as gas prices continue to fall (chart). Schenker expects the price

per gallon will drop to \$2.10 in November and hover there heading into 2007.

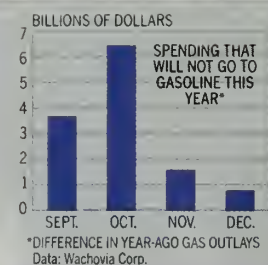
As the benefit from cheaper pump prices fades, consumers should get a boost from another lower-priced fuel. Schenker expects natural gas prices will average about \$7.75 per million Btu during

the fourth quarter, a 40% drop from \$12.83 in the same period in 2005. According to the Energy Information Administration's October forecast, households using natural gas for heating should pay an average of \$119 less this winter, although those using heating oil are expected to pay more. The biggest drop in heating bills will likely come in December.

That extra discretionary income should be spent largely on nondurable goods and services. Retailers selling big-ticket items, such as appliances and vehicles, are less likely to see a boost since the sharp slowdown in housing prices and higher interest rates play a bigger role when it comes to those spending decisions. Even so, the energy could wind up being a nice gift for retailers heading into the holiday season. ■

—By James Mehring in New York

## MORE MONEY TO SPEND ON OTHER ITEMS





The verdict.

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# The Business Week

## News you need to know

EDITED BY HARRY MAURER



**A Shadow Over Buyout Firms** Will G-men drag private equity into the public glare? *The Wall Street Journal* reported on Oct. 10 that the **Justice Dept.** is looking into potentially anticompetitive behavior by top private-equity funds. Letters to the likes of **Kohlberg Kravis Roberts** and **Silver Lake Partners** seek behind-the-scenes tidbits from bidding deliberations since 2003. Regulators are looking into how buyout clubs share information about targets. Do players observe tacit agreements to avoid pushing up deal prices? Stay tuned.

Not that this is choking off the going-private craze. On Oct. 9 the controversial family that controls cable TV provider **Cablevision**—along with plum properties such as the **New York Knicks**, the **New York Rangers**, and **Madison Square Garden** (photo)—unveiled a \$7.9 billion buyout offer, nearly a 13% premium over the stock price at the time. The bid struck some analysts as pricey, but others figure that **Time Warner** may ultimately buy the cable assets and that the Dolans want to be in a position to reap all the profit.

**North Korea's Nuke** Those wiggly lines on seismographs on Oct. 9 spelled a serious setback for **President George W. Bush's** foreign policy and for those of **Japan, China,** and **South Korea** as well. North Korea's nuclear test makes an unstable corner of the world even scarier. But markets barely shrugged, and no major credit rating company has downgraded South Korea, perhaps because a preemptive U.S. attack on **Pyongyang** seems unlikely.

**ONLINE** See "Costing the unthinkable," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Exiting Executives** The week took a high toll in corridors of power. **Christian Streiff** parachuted out of CEO spot at **Airbus** on Oct. 9, having been there just months, after a struggle with parent **EADS**. **Andrew Kelvey**, chief of job-search giant **Monster**, handed him a pink slip the same day, partly impelled by an inquiry into stock-option practices. On Oct. 10, **Tim Donahue** said he would retire at yearend as chairman of **Sprint Nextel**, which has been struggling, and **David Kies** quit as chairman of biotech **ImClone Systems**, which is under siege by investor **Carl Icahn**. On Oct. 11 the options scandal brought out **CNET Chairman and CEO Shelby Bonnie** and **McAfee Chairman and CEO George Samenuk** and **President Kevin Weiss**.

See "Wayward Airbus," page 46

**ONLINE** "Airbus: The ride just got bumpier," and "Is Bonnie running out for Sprint's Fort?" [www.businessweek.com/go](http://www.businessweek.com/go)

**Video Bonanza** The twentysomething founders of online video mecca **YouTube**, **Steve Chen** and **Chad Hurley**, picking their pick of would-be swains, finally chose one. On Oct. 9 they accepted an all-stock, \$1.65 billion bid from **Google**. More evidence of Dot.com Boom II?

See "Smart move or silly money 2.0?" page 34

**ONLINE** "Google's video-search challenge" [www.businessweek.com/go](http://www.businessweek.com/go)

**A Plastic IPO** If you can't beat 'em, join 'em. In a move to stay competitive and raise much-needed capital, **Visa** lowered archrival **MasterCard** and said on Oct. 11 that it would go public after years of denying it would. The U.S. arm of San Francisco credit-card outfit will morph from a member-owned operation into **Visa USA**, a for-profit, public company, in the next 12 to 18 months. **MasterCard** went public in May, and its shares have soared 76% since.

**En Garde, GM!** **Kirk Kerkorian** didn't waste any time tossing down the gauntlet. On Oct. 6 his right-hand man, former **Chrysler** and **IBM CFO Jerome York**, bade the **General Motors** board adieu. York and Kerkorian were miffed that GM didn't go along with their bid to snuggle up with **Nissan**. They also claim the board is too cozy with management. Many think Kerkorian, who owns 9.9% of GM stock, may launch a proxy fight. But given GM's earnings uptick, it may not be easy to win over shareholders.

**ONLINE** See "GM: Things are about to get noisy" [www.businessweek.com/go](http://www.businessweek.com/go)

**Alcoa: Not So Shiny** **Alcoa** is the industrial sector's canary in a cage, reporting earnings first every quarter. Based on its third-quarter numbers, manufacturers need oxygen. The aluminum giant said on Oct. 10 that its income jumped 86% from a year earlier, to \$537 million, on a 19% bump in sales. Sounds dandy, but analysts have been expecting profits of \$673 million. **Alcoa** blamed the miss on declining aluminum prices and weakness in the automotive and home-building sectors. Its share price sank 5% on Oct. 11, closing at its lowest level this year.



**Oil Tightens** The price of oil may be down, but the Fed's inflation hawks aren't relaxing. The **European Central Bank** on Oct. 5 pushed up its benchmark rate for the first time in less than a year, to 3.25%, and warned that an another-quarter-point hike is likely in December. It's a signal that the ECB still spies oomph in the European economy, and expects to grow 2.6% this year. Some outside economists figure Europe will outperform the U.S. in 2007 as corporate restructuring feeds a productivity surge.

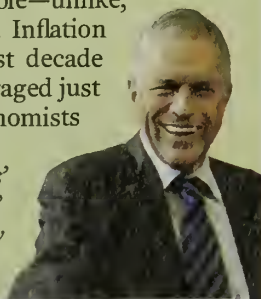
**Steel Rumble** Global trade produces winners and losers, and union workers at **Goodyear Tire & Rubber** know they're in a group they're in. Three years after granting cuts in benefits, and jobs, more than 12,000 members of the **Steelworkers** went on strike on Oct. 5 after the company insisted it needs to trim paychecks even more and close two more U.S. plants. Back in 2003, Goodyear, the world's largest U.S. tiremaker and No. 3 globally, was on the verge of bankruptcy. But today the Akron company is profitable, and CEO **Robert Keegan** received \$5.6 million in bonuses in 2005 for turning things around. So far, Goodyear has been using imported tires to offset the strike. And there's a reason in part to slower Big Three car production.

**PC networking pioneer Ray Noorda** died at age 82 on Oct. 9. In 1982, Noorda co-founded **Novell**, which once ruled the networking software market but lost out to its rivals, **Microsoft**. In the 1990s, Noorda became obsessed with beating Microsoft and took the software behemoth on successfully in one market after another. Hampered by memory loss that was the first sign of Alzheimer's disease, he was fired from Novell in 1995 and formed a venture capital firm called **Canopy Group**.

## Award of the Week

**Nobel Prize** for a proof of futility: Not inspiring, but highly relevant for economic policy. **Edmund Phelps** of **Columbia University**, who won the prize on Oct. 10, showed that the government, much as it might wish, cannot permanently boost growth by accepting slightly higher inflation. Why? When workers catch on that inflation is eroding their pay, they ask for more money. Higher wages cause prices to rise faster, setting off a spiral that doesn't end until the economy slows and unemployment rises back to its natural level. Phelps's counter-surprising proof is now gospel at the Fed. The only weak spot is that the "natural" rate of unemployment is unstable and unpredictable—unlike, say, the freezing point of water. Inflation has been restrained for the past decade even though joblessness has averaged just 6% way below where most economists have pegged the natural rate.

**See "Why Edmund Phelps' economic theory matters,"** [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)



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## NET ACQUISITIONS

# SMART MOVE OR SILLY MONEY 2.0?

If YouTube ends up being a \$1.65 billion mistake, Google can afford it. That's why Old Media is wondering how to play this new game

**BY TOM LOWRY AND ROBERT D. HOF**

**I**MAGINE BEING PHILIPPE P. Dauman, who has been the chief executive of Viacom Inc. for a mere six weeks. His boss, Chairman Sumner M. Redstone, booted his predecessor, Tom Freston, in large part because Freston was too slow to do a big Internet deal. The expectation is that Dauman, who ran his own investment firm, will be quicker to act. In turn, the assumption is that shareholders will applaud and the stock will soar.

But the view from Dauman's 52nd floor Times Square office is foggy at best. Only last summer, people were saying News Corp. Chairman Rupert Murdoch had overpaid for the social-networking site MySpace.com. Now the \$580 million price tag looks cheap. At least it does compared with the \$1.65 billion Google Inc. is paying for YouTube Inc., a 20-month-old video-sharing site with zero profits. Viacom's team held talks with YouTube founders, Chad Hurley and Steve Chen, too, but the negotiations never went anywhere.

Everyone from Time Warner and Viacom to Yahoo! and Microsoft is under enormous pressure to acquire the next MySpace or YouTube. But amid steadily rising valuations, Old and New Media ex-

ecutives alike are afraid of overpaying and being punished by their shareholders. "We are seeing a valuation gap that sometimes doesn't make sense," says Wade Davis, Viacom's senior vice-president for mergers and acquisitions, who has overseen a handful of Web 2.0 deals whose prices collectively are well below what Google is paying for YouTube. Time Warner Chairman and CEO Richard D. Parsons, still dealing with the aftermath of the disastrous merger with AOL in 2001, has similar concerns. "We're interested in businesses that endure," he says. "You are not going to grow a business over the long term if it's being valued at 60 times earnings."

### FICKLE YOUTH

PAYING UP IS LESS of a concern for a Google, of course. While Old Media continues to suffer from lagging stock prices and tepid advertising revenues, Google, Microsoft, and Yahoo have huge cash hoards, manageable debt, and, in the case of Google, a lofty stock price. Paying \$1.65 billion for YouTube amounts to less than 2% of Google's \$130 billion market cap—and the big bet on the video-sharing site could be as much about gut and ego as it is about hard-nosed business sense. And

even if Yahoo decides to spend \$1 billion to acquire Facebook, the popular social networking site for college students, it isn't likely to break its bank, either.

Nonetheless, some analysts see a froth in the market, and the risk remains that even highfliers like MySpace or YouTube could flame out if their youthful audiences decide to move. "Every monkey with a video-sharing site is going out there and asking for double their previous valuation," says Paul Drosky, a venture investor with Canadian VC firm Ventures West Management.

What really has the media world in a tizzy is the assertion by RBC Capital Markets analyst Jordan Rohan that MySpace could be worth \$15 billion in three years—nearly 30 times what News Corp. paid for it. Rohan says the social-networking site's "trajectory for profitability" is every bit as steep as Google's. But his reasoning is based largely on the fact that Google agreed to pay MySpace \$900 million over three and a half years in exchange for giving up its search provider.

Critics have pounced on Rohan. One is Robert Holthausen, a finance professor at

**YOUTUBERS** Hurley and Chen met with Viacom, but talks went nowhere





the Wharton School at the University of Pennsylvania. He notes that Google trades at 55 times earnings, so if you were to apply that multiple to MySpace, it would need about \$270 million in annual profit to justify a \$15 billion valuation. Furthermore, Holthausen questions whether Google is even an appropriate yardstick for MySpace and whether Google's 55 times earnings is a realistic fundamental value in itself.

Whether or not a Web 2.0 bubble is in the making, how valuations get assigned to these New Media properties is certainly more art than science at this point. Their prices can't realistically be based on hard and fast metrics like, say, current revenues or profits. "There is no neat, concise, formulaic approach," says Terrence G. Kawaja, a managing director and online media specialist with investment banking boutique Gridley & Co. For the most part, sites are being valued largely on existing traffic (unique page views and monthly visitors) and on the potential to leverage those audiences to sell advertising in the future.

Since most of the traffic on these sites is viral, their costs to attract users are very low, if not zero. Advertisers love that, or so goes the deal broker's pitch to potential acquirers. Combine that with "the medium of all mediums, video, and you have a winner," Kawaja says. "By putting the rich medium of video together with reportable and traceable ad metrics, and ads that can be targeted to any demo, it's nirvana for a marketer." The other factor driving these valuations is the competitive fervor from bidders that ratchets up the prices. "There's definitely defensive buying," says



**“You are not going to grow a business over the long term if it's being valued at 60 times earnings.”**

—Dick Parsons  
Time Warner Chairman and CEO

Rodd C. Langenhagen, managing director at Revolution Partners, a Boston M&A shop. If Google had not faced other potential bidders for YouTube, who knows if the price would have reached \$1.65 billion?

Even so, many people believe Google, more than most companies, can easily justify the price. "This is a big slug of

[content] inventory," Leapfrog Ventures partner Rip, who ran Knight-Ridder's venture arm in the late 1990s. In other words, with YouTube in its grasp, Google can more easily place ads on pages where they are viewed or even in the videos themselves. As a result, Google can take a bet on continued growth at YouTube, which serves more than 100 million video clips per day, up from 10 million in January.

Now, the question is whether YouTube's valuation will encourage up-and-coming buyout contenders. So far, it looks like a few sites have demonstrated growth and engagement with users that might command similar prices. Exhibit A: Facebook, whose value as determined by venture investors has jumped from \$100 million in its first round in September, 2004 to \$500 million in a second round last April. And that's just the tip of the iceberg. Sources say bidders such as Yahoo are willing to pay up to \$1 billion today. "We're not in a bubble mode," says Michael J. Montgomery, the Santa Monica investment banker who sold MySpace to News Corp., the

parent of site Grouper Networks Inc. to Sony, or another one, iFilm.com, to Viacom. "When a quality company with good traffic comes up, you can get a lot of companies who will bid on it."

Maybe so, but even a titan like Microsoft isn't necessarily prepared to pay a big premium for a Web 2.0 company. Google surprised that Google would pay \$1.65 billion for YouTube, CEO Steve Ballmer told *BusinessWeek* (box), though he acknowledged he might have paid more. For Old Media companies, the value is even higher since they lack the agility of a Microsoft, Yahoo, or Google. mesh's acquisition with their extensive networks of daily users.

So what can a Time Warner or Viacom do to avoid being left behind? For starters, they can cut distribution deals with the line upstarts. On Oct. 9, just hours after YouTube announced its deal with CBS Corp., said it would offer short-form programming to YouTube in exchange for advertising revenue. Warner Music Group, BMG Music Entertainment, and Universal Music announced similar deals with YouTube. It may be that some traditional media executives are beginning to

## Are These Companies Next?

A handful of Web 2.0 companies are prompting takeover buzz

| COMPANY     | UNIQUE VISITORS*<br>(MILLIONS) | DESCRIPTION                                                                                                              |
|-------------|--------------------------------|--------------------------------------------------------------------------------------------------------------------------|
| Facebook    | 13.3                           | The second-largest social-networking site after MySpace has a lock on the prized college and just-post-college audience. |
| Xanga       | 7.0                            | Teens love this blogging community, now the third most popular social-networking site.                                   |
| Heavy       | 6.9                            | Hip, flashy video site attracts young males—and mainstream marketers.                                                    |
| Photobucket | 4.7                            | Leading photo-sharing site moved into video last April                                                                   |
| Bebo        | 2.4                            | Fast-growing social-networking site rivals MySpace in England and Ireland.                                               |
| Digg        | 1.3                            | Its mostly educated male users visit the site to submit a story or blog posting they found online.                       |

\*in September

Data: ComScore Networks Inc., *BusinessWeek*



# Ballmer: They Paid How Much for That?

the people running the richest companies are awestruck by Web 2.0 valuations. Microsoft Corp. Steven A. Ballmer, who sat down with BusinessWeek editors and writers hours before Google announced its \$1.65 billion purchase of YouTube, questioned how the online video service could fetch so much. This is an edited transcript of the conversation.

## What do you make of the possible gap between Google and YouTube?

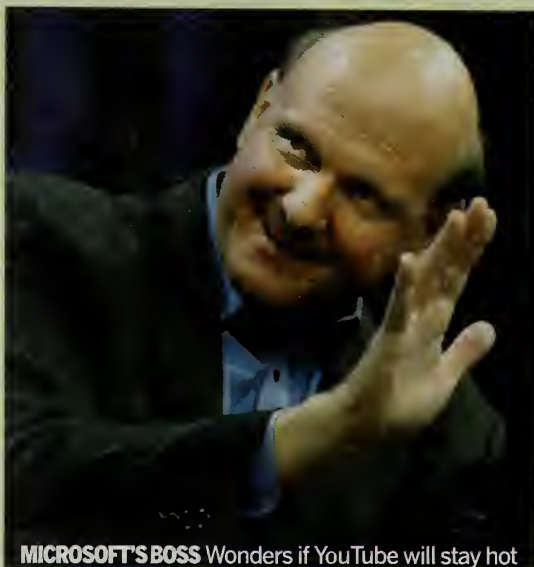
[You've got to ask,] could Google have done whatever it is they're hoping to do without paying \$1.6 billion? Is YouTube really some permanent, long-term thing, or is it a fashion? I'm not saying it is a fashion. But every time we do valuations, I wonder if we can afford to keep this hot for 10 years. I'm sure somebody at Google has to do the same analysis, because \$1.6 billion is more than 1% of market cap.

Is there a business model? Right now, there's no business model for YouTube that would justify \$1.6 billion. And at the end of the day, a lot of content that's up there is owned by somebody else. The truth is, what Google is doing now is transferring wealth out of the hands of copy-right holders into Google's. So media companies around the world are all threatened by Google. Why? Because basically Google is telling you how much of your ad revenue you get to keep. They better get some competition. Us, Yahoo—somebody better break through or you can short all media stocks right now.

Getting back to the core question,

to own these distribution sites if you can be guaranteed protections and revenues for their copyrighted materials. Venues from these outlets will be at least for now, compared with what they generate by selling programming on cable and satellite TV.

Media giants are building their digital businesses. One is Walt Disney, which just relaunched ABC.com,



**MICROSOFT'S BOSS** Wonders if YouTube will stay hot

I am surprised that Google would pay \$1.6 billion for it.

## You're clear as a bell on the YouTube valuation...

I'm not saying it is overvalued. I'm not saying I wouldn't write a check for that amount of money. I might. If you're asking me if I would offer \$1.7 billion if no one else was offering \$1.6 billion, no, I wouldn't do that.

Look, there are only [a few] buyers who can buy anything over a billion dollars in this space. There's us. There's eBay. There's Yahoo. And there's Google. I don't think there's anybody else. Even Amazon has a market cap of only \$13 billion. I don't think they're going to do too many \$1 billion deals.

## In general, what do you think about Web 2.0 valuations?

There's hot companies, and there's

where it is streaming programs like *Lost*, *Grey's Anatomy*, and *Ugly Betty* just days after they air on TV. What's next? A relaunch of Disney.com will include streaming of Disney movies. And although Viacom continues to get a slew of pitches, CEO Dauman recently told a packed Goldman, Sachs & Co. investor conference that as time goes on, there may be less urgency to do deals as Via-

everything else. The question is what's the value of an eyeball. Take Facebook. If you knew for sure that you were going to have the kind of minutes of eyeball time by the percentage of college students that Facebook has today for the next 15 years, it's an easy billion-dollar check to write, even though it doesn't have a business model that establishes that. If [Facebook founder Mark] Zuckerberg is going to grow older, he's going to lose his "hip," the site is going to be replaced by Facebook Prime—you know, the guy will be old; pretty soon he'll be 25. It's not like it's so sticky—college students churn every four years. If it's that, it's not worth anywhere close to a billion.

We're excited about Facebook. We're selling all the advertising for it. We're more excited now that we're selling ads for it than we were before.

## These are hits-based phenomena. Don't you and others have to monetize very rapidly before people shift into something else?

If they are hits-based, which is the implication I've made, and you pay a lot of money, you're going to have to move in, milk, and get out. Or, it may turn out that the money is in the infrastructure. What is Google to MySpace? It's the advertising infrastructure. In some of these things, you'll have to decide, if you're the big guys, do I want to play at the application level? Or do I merely want to play at the commerce and other platform level in a way that strengthens the rest of my assets and allows me to make money?

com's internal digital operations grow stronger across such brands as MTV, Comedy Central, and Nickelodeon. "We see tremendous opportunity," Dauman said, "with what we have inside." Yes, but every media executive probably dreams of grabbing the Next Big Thing out from under Google's nose. ■

—With Sarah Lacy, Roben Farzad, and Ronald Grover



COMPENSATION CONTROVERSY

# MASTER OF THE OPTIONS UNIVERSE

Chipmaker Analog Devices appears to have used every trick in the book

BY JANE SASSEEN

**C**OMPANIES FROM Apple Computer to UnitedHealth Group to McAfee have played games with stock option grants in recent years, often to the detriment of shareholders. The list of techniques that can be used to boost the value of options received by executives, or to minimize the cost that must be reported, is long, from repricing or rejiggering the estimated value of an option to so-called speed-vesting, backdating, spring-loading, and more.

But amid that litany, one company stands out: Norwood (Mass.)-based semiconductor maker Analog Devices Inc. Not only has it used each and every trick in the book, its profits have gotten a bigger boost from several controversial techniques than all but a handful of companies. "It's rare that you get a company taking advantage of every loophole possible to maximize the return to executives at the expense of shareholders," says Robert McCormick, head of proxy research at Glass, Lewis &

Co., an advisory service for institutional shareholders. "But they appear to have taken the [everything but the] kitchen sink approach."

Start with the practice of accelerated vesting. U.S. companies had to begin deducting the cost of their options from income starting in fiscal 2006. By pushing up the vesting of outstanding options ahead of that deadline, however, some

avoided a big charge. Last October, Analog speed-vested options valued at \$188 million, which pumped up its 2005 aftertax income by \$134 million. Only Viacom Inc. and Sun Microsystems Inc. boosted earnings more from accelerated

vesting, according to Jack T. Ciesie, publisher of *The Analyst's Accounting Observer*.

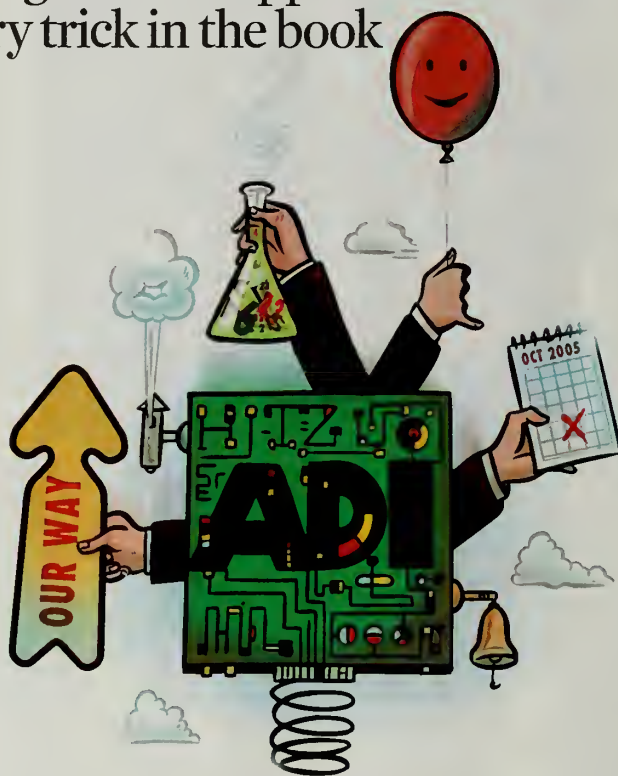
Like many companies, Analog also trimmed options expenses by tinkering with the formulas used to value them. That's doable because the expense deducted for an option is simply an estimate based on assumptions about such things as how volatile the underlying stock is and how long holders will hang on before cashing in their options. The more favorable the assumptions, the lower the costs. While such changes can be legitimate, analyst David L. Baskin of Credit Suisse warns that such shifts can also be red flags for aggressive accounting.

The sums involved are hardly pocket change. Zion points out that in 2005, Analog slashed its estimated options volatility from 69.2% to 27.4%—the biggest among S&P 500 companies. That move alone, he estimates, Analog reduced the cost of its 2005 options by \$173 million, an amount equal to 31.6% of its operating income. Only Intel earned bigger savings from making such a shift.

Analog also gained considerably by reducing the expected life of its options. By cutting the time it thinks employees will hold onto them from an average of 5.8 years to 5 years, Zion figured the chipmaker trimmed costs by an additional \$20 million. Only five other companies pocketed bigger savings from this change.

Analog spokesperson Maria Tagliaferro defends the company's practices. Since the price at which many of the options could be exercised was well above the stock price when the speed-vesting occurred, she says the expense associated with them was out of line with their real value to employees. And she says the new volatility estimates—a measure of the "implied" future volatility based on the price Analog's options get in the market—are more accurate than the old figures, which reflected Analog's historical volatility. Likewise, she adds, the shorter holding period is a truer number than the old one.

The semiconductor maker was one of the first to be caught up in the options backdating scandal. Backdating, when companies claim options were granted earlier than they really were, provides a bigger payoff for recipients related practice, called spring-loading.



## Playing the Options Game

Here's how much Analog gained from these three techniques:

ACCELERATING THE VESTING OF OPTIONS GRANTED BEFORE 2005  
**\$188**  
MILLION

LOWERING THE ESTIMATED VOLATILITY OF ITS OPTIONS  
**\$173**  
MILLION

REDUCING THE ESTIMATED TIME HOLDERS WILL HANG ON TO OPTIONS  
**\$20**  
MILLION

Data: Company reports, Credit Suisse Group



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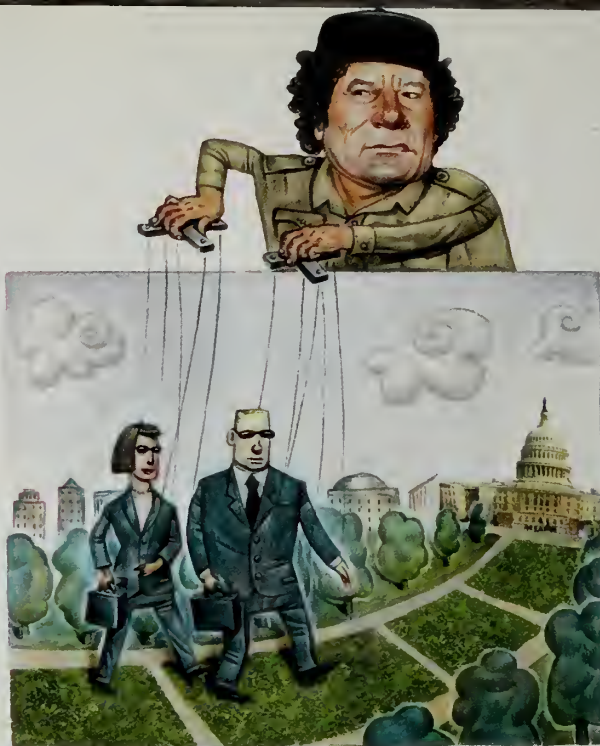
volves issuing options just ahead of good news, so that the value of the option is virtually guaranteed to bounce. Roughly 140 companies have either launched internal probes or are being investigated by the Securities & Exchange Commission or the Justice Dept. for options timing misdeeds.

Last November, Analog and CEO Gerald G. Fishman agreed to settle civil fraud charges that the company had engaged in both backdating and spring-loading of the options it granted to directors, executives, and other employees on several occasions from 1998 to 2001.

Under the tentative settlement, which Analog and Fishman have agreed to without admitting or denying guilt, the company would pay a \$3 million fine and would reprice some options given to Fishman and other directors during those years. Fishman would also pay a fine of \$1 million and disgorge gains from some options sales. The settlement, however, has never been finalized. In May, the U.S. Attorney also began probing the same issues.

The company's use of controversial pay practices goes back many years. In 1998, following a slump in the stock, it repriced a big slug of options, a tactic long criticized by investors. And last February, Analog ran into a storm of criticism when shareholders found out that the company owed Fishman \$145 million in deferred pay built up since 1995, much of it from gains on stock options. Analog also paid Fishman and others interest at better-than-market rates. Fishman pocketed \$8.7 million in interest on his stash in 2005 alone.

Such practices have intensified scrutiny of Analog. Last spring, Glass Lewis gave Analog an "F" on pay-for-performance. Along with rival proxy adviser Institutional Shareholder Services, it urged institutional investors to withhold support from director James Champy, a compensation committee member. The well-known management guru received the backing of only 73.6% of the votes—a big sign of shareholder unrest. Chairman Ray Stata says Analog has modified some of its practices. Repricing is no longer allowed, for example, and it now issues options on the same date every year. He adds that the company openly communicates with shareholders about the decisions it makes on compensation; after that, it's up to investors to decide what to do with the stock. With shares off about 27%, to \$30, since February, it looks like many already have. ■



## MAKEOVERS

# LOBBYING FOR LIBYA

## Hired guns are helping it walk the D.C. walk

BY EAMON JAVERS

**L**IBYAN COLONEL MUAMMAR Qaddafi has never been to Washington. But that hasn't kept the leader of the once-rogue nation from making his voice heard in true American fashion: through a team of hired guns.

Libya, perhaps most reviled for its downing of Pan Am Flight 103 over Lockerbie, Scotland, in 1988, has taken steps in the past few years to legitimize itself. The country has paid millions to the families of Lockerbie passengers, and it shut down its program for weapons of mass destruction. In turn, the U.S. has lifted sanctions and set the stage for the return to Libya of American businesses, including oil and aerospace concerns.

But Libya still has a long way to go. "The experience, the technology, and the economy of the U.S. will be very important to us," says Abdul Hamid Yahya, Libya's deputy ambassador in Washington. And that's where Libya's private-sector diplomatic corps comes in.

In 2004 the country began shopping

for Washington help. Former Senator Bob R-Kan.) and Green Traurig, Jack Abramo, a former firm, vied for work. The country's need for operatives with profiles but deep connections in Washington Arab circles.

One of the first hired was Fahmy Hudome International, founded by Randa Fahmy Hudome, a well-connected Egyptian American Republican and a former Assistant Deputy Secretary of Energy in the second Bush Administration. Fahmy Hudome says she played a role in efforts to remove Libya from the U.S.

terrorist list. Justice Dept. records show in the past year she has also met with Libya's behalf with staff on the Senate Foreign Relations and House International Relations committees.

Fahmy Hudome subcontracted lobbying work to JAS International, by Jill A. Schuker, a former director of communications at the National Security Council during the Clinton years.

Meanwhile, C&O Resources Inc. has been the country's political tour guide. Chief Executive Sandra L. Charles saw meetings in March for Dr. Osama bin Laden, a Libyan American working on restructuring the Libyan economy, and Vice-President Dick Cheney's staff at the White House. Charles had earlier advised the Libyans on the benefits of demonstrating a commitment to economic and political reforms. "When you talk to people in the Administration about Libya, everybody is keen to see the form," Charles says. Last year Libyans organized a women's empowerment seminar in Tripoli.

The three small firms have reaped money: C&O Resources billed almost \$400,000 in its first year. Fahmy Hudome was paid \$375,000, Schuker \$120,000. The road ahead is not clear. In 2006, C&O Resources and Fahmy Hudome International have worked without contracts and without pay. "We have no reason to believe they won't make good on it some point," Charles says.

But Libya seems to be reevaluating options. "They still have a relationship with us, and they hope it will continue," says Libya's Yahya. "The reality now is that the contract is expired." ■

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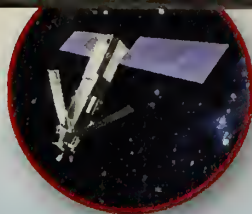
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## HOMELAND SECURITY

# BOEING'S BORDER PATROL

BY DAWN KOPECKI

**B**oeing Integrated Defense Systems is getting started on its \$2 billion contract from the Homeland Security Dept. to build a 6,000-foot "virtual fence" along the U.S. borders with Mexico and Canada. The Chicago-based company will spread the work among nine major subcontractors.\* The first phase is scheduled to be completed by May, 2007, and includes 28 miles of high-tech protection along the Mexican border at Sasabe, Ariz.

The heart of the fence is 1,800 sensor towers equipped with radar, cameras, and other gadgets to help Customs & Border Protection detect and prevent unwanted visitors from entering the U.S. With Boeing's help, *BusinessWeek* presents the first tour of Homeland Security's virtual fence:

\*Other major companies involved in the project include: Unisys Global Public Sector, USIS, Centech Group, Perot Systems, Lucent Technologies, Data: Boeing Co.

### UNMANNED AERIAL SYSTEMS (UAS)

- A single agent can launch and control a UAS, a known as a drone airplane, which weighs as little as 10 lbs. and can track suspects within a 6-mile radius for up to 90 minutes.
- Kollsman Inc. is the leading contender for the contract.

### SENSOR TOWERS

- Rising 80-ft. to 200-ft. tall, depending on the terrain, they come with radar equipment that can spot and home in on movement.
- DRS Surveillance & Reconnaissance Group is building the first nine towers, Kollsman is providing the electro-optical and infrared cameras, and L-3 Government Services Inc. is constructing the base.

INTERNATIONAL BORDER

POINT  
OF ENTRY

### SATELLITE PHONES

- Agents will be able to talk, get data and possibly video anywhere in the world without losing their signal, even in canyons or other places that don't have cellular towers.
- Iridium Satellite will set up the system.
- Motorola leads the pack of contenders vying to provide the phones.

BORDER  
STATION

AGENT  
VEHICLE

ILLUSTRATION BY JOE CALVIELLO/BW



ROW  
GROU  
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DAIMLERCHRYSLER IN THE  
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## AUTOS

# WHY YOU'RE PAYING MORE TO RENT A CAR

As Detroit quits building fleet vehicles, costlier cars are costing customers

BY DAVID WELCH

**D**ETROIT HAS LONG pumped out cars that no one wants to buy, only to fob them off on rental fleets for next to nothing. But as Ford Motor Co. and General Motors Corp. downsize, they are closing plants that for years have churned out mostly plain-vanilla rental cars, like the football-shaped Ford Taurus or the innocuous Chevrolet Malibu Classic. With fewer of those tired old models left to buy, rental companies will have to start ponying up for better, more desirable cars. That means higher rates for the weary traveller.

A lot higher, it turns out. As Ford and GM race to match factory production to retail sales, they are raising the prices and fees they charge the likes of Hertz Corp. and Avis Rent a Car System. So far this year, the rental agencies have jacked up the average price at the counter for a mid-size car such as the Taurus by more than \$7, to \$59 a day, says Neil Abrams, president of Abrams Consulting Group Inc. in

Purchase, N.Y., which closely follows the rental car business. That follows a jump of just \$2 a day during all of last year. Rental agencies can't ease the cost pressure by acquiring more Asian models. Japanese carmakers limit their rental sales; the Koreans sell more to fleets, but not enough to offset the rise in prices. Now, with airport fees, taxes, and insurance, the daily rate for tooling around in a Taurus can reach \$90. "Costs to the rental car companies have gone up dramatically in the past 24 months and are up 20% just this year," says Abrams. "You bet they are going to pass it on."

For years, consumers and rental firms alike have benefited from the fact that Detroit has been outproducing demand. To keep plants humming, and to keep busy the union workers they were contractually forbidden from firing, Detroit's Big Three offered

## TRADE OFF

The bright side for renters? Nicer cars with luxe options

huge rebate  
0% financing  
sold discounts  
bare-bones  
els to rental

In some cases the carmakers practically gave the cars away. For example, a manufacturer would actually give a rental company \$1,000 in rebates to car for its rental fleet. Then the auto maker would agree to buy the car back four months at the sale price, minus a month for depreciation. Do the math. The rental agency basically got the car free, says Abrams.

## SMALL BOON

THESE DAYS, THE PRICES are rising, the rebates are falling, says Marya Keller, an auto industry analyst who sits on the board of Dollar Thrifty Automotive Group Inc. Detroit also is buying fewer of the used rental cars, leaving rental firms to shoulder the risk of losing money on the resale of a used car. Since stripped-down models are tough to sell, the rental companies are paying for options like leather seats, sun roofs, better stereos. GM, for example, has cut sales to rental fleets by 7% this year. More than 80,000 of the 700,000 cars GM will sell this year are equipped with sun roofs; none had them years ago. "All of us were the beneficiaries of excess production," says Keller.

The rental companies think prices on cars will only get worse in the foreseeable future. By the end of the month, Ford will close its Atlanta plant, which made about 150,000 Taurus cars a year, or about 8% of U.S. rental business. This year GM will close a plant in Ontario that makes the oft-rented Pontiac Grand Am sedan. Last year GM closed a La Porte, Mich., plant that built the old Pontiac Grand Am and Chevy Malibu Classic.

Higher pricing is a small boon to Detroit's carmakers, who struggle to

a buck selling anything. "Rental business doesn't have to be bad business," says Paul Ballew, GM's executive director of government relations and market analysis. But it may be a silver lining for consumers, too. Instead of fussing with 1990s crank windows, renters may be plugging into a new Fusion or Chevy Impala. It's a cost more, but at least it's a nicer ride than old no-frills Taurus.

## THE STAT

**\$59**

The average per-day to rent a midsize car, excluding fees, up from \$51.49 in January

Data: Abrams Consulting Group Inc.

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SNAFUS

# WAYWARD AIRBUS

Cross-border clashes have led to costly production errors. Job One for a new CEO will be to unify the jetmaker



BY CAROL MATLACK

**A**IRBUS' A380 DOUBLE-decker jet is two years behind schedule, sending billions of dollars in potential profits down the drain. But the reason sounds too simple to be true: Airbus factories in Germany and France were using incompatible design software, so the wiring produced in Hamburg didn't fit properly into the plane on the assembly line in Toulouse.

It's one of the costliest blunders in the history of commercial aviation, and it has plunged Airbus into crisis. Chief Execu-

tive Christian Streiff quit on Oct. 9 after only three months on the job, following clashes with Airbus' parent, European Aeronautic Defence & Space Co., over how to sort out the mess. The delays in the A380 mean EADS will take a \$6 billion profit hit over the next four years, and the resulting cash crunch could slow Airbus' plans for a new midsize wide-body to challenge Boeing Co.'s hot-selling 787 Dreamliner. Airbus has fallen far behind Boeing on total aircraft orders this year, logging only 226 through September vs. 723 for its U.S. rival.

How could the Europeans have blown it so badly? The software debacle exposes

a fundamental flaw in Airbus. Far from the seamless, pan-European image it likes to project, Airbus is terribly balkanized, with its factories in Germany, France, Britain, and Spain clinging to traditional operating methods and boring cross-border jealousies. "It's still, in part, a juxtaposition of four companies," Streiff told the French newspaper *Le Figaro* in the only interview he has given since resigning.

Each of those four companies comes with a government attached. Consistent political meddling, it seems, is the price Airbus must pay for billions of dollars in low-interest government loans that



**DELAYED AIRMAIL**

The giant A380 hit a snag when some components didn't quite match

and fuel its growth. Politicians lean on the company to spread work across its 16 European factories, sapping efficiency and increasing the risk of production delays. "The fairy tale has turned into a nightmare that even the fiercest Europeans wouldn't have imagined possible," according to Eric Chaney, Morgan Stanley's chief European economist. The \$16 billion A380 project was a part of that nightmare. The plane's matched wiring was produced by Airbus' Finkenwerder factory, a vast complex near the port of Hamburg that employs more than 10,000 people. In other respects, Finkenwerder would be

the most logical site for the A380's final assembly line. Thanks to the plant's waterfront location, the plane's wings and fuselage—too big for conventional land and air transport—could have been delivered by ship directly to the factory door. Instead, political horse-trading led Airbus to put the assembly line in landlocked Toulouse, where the huge components have to be shipped on custom-built river barges and flatbed trucks. More than 100 miles of highway had to be widened and straightened so the trucks could get through.

Hamburg, though, did get a piece of the action. Finkenwerder was assigned

to build some sections of the A380 fuselage, as well as the wiring for the cabin power supply, lighting, and electronic systems such as video-on-demand for passengers. There was just one problem. Airbus' French factories, where the rest of the fuselage was manufactured, used the latest version of computer-aided design software made by Dassault Systèmes, a spin-off of French airplane maker Dassault Aviation. But Hamburg design engineers were using an earlier version of the software, from the 1980s. "The two systems are completely different. They have nothing to do with each other," says Robert Weigl, the Munich-



based director of professional services for Proficiency, a Waltham (Mass.) company that advises manufacturers on design software.

When bundles of the cabin wiring started arriving in Toulouse early this year, assembly slowed to a crawl. Workers tried to make them fit into the fuselage by pulling them apart and rethreading the wires, but that proved to be impractical, and the effort was abandoned. Airbus says it has introduced new software to correct the wiring design, but it will take months for engineers to get up to speed on the new system. That's why Airbus now predicts it won't deliver the first A380 orders until late 2007.

Why didn't Airbus spot the problem earlier? The company isn't talking, but people familiar with the situation say that some workers and mid-level managers tried to raise alarms and were rebuffed by their superiors. "The management in Toulouse didn't listen," says Rüdiger Lütjen, a labor-union leader who sits on the Hamburg factory's workers' council. Adds Heinrich Grossbongardt, a Hamburg aerospace consultant who works with A380 suppliers: "Anyone who could look behind the scenes and wanted to see the problems, saw them."

Another stumbling block was the lack of a full digital mock-up of the A380. Such three-dimensional models are especially useful for electrical wires, which are difficult to track in two dimensions as they twist and bend through the plane. Boeing has such a mock-up for the 787, and Dassault Aviation uses one to build its corporate jets. Yet Airbus

signed its first major contract for mock-up software only within the past year, when the A380 was already in production. "Airbus just didn't put a high priority on [updating its software]," says Hans Weber, CEO of San Diego-based aviation consultant Tecop International, who has close contacts with the company's German operations.

## "WE TAKE THE BLAME"

STREIFF PROPOSED tightening management control over the A380 by reassigning the Hamburg factory's share of the project to Toulouse. Not surprisingly, Hamburg employees are furious. "The management screws up, and we take the blame," fumes a grim-faced worker leaving

the Finkenwerder plant at shift change.

It's not clear whether Streiff's turnaround plan will survive. The CEO quit because the EADS board of directors, sensitive to pressure from various national constituencies, would give him the freedom he needed to structure. But Louis Gallois, the EADS chief executive who was named to succeed Streiff, has promised a "rigorous revamp of manufacturing operations." "We have to ask questions about our assembly lines, to rationalize them," said in a radio interview in Paris on Oct. 10. Any plan to cut jobs in Germany face stiff headwinds, though, as politicians and labor leaders are already mobilizing for a fight.

Airbus customers, meanwhile, are rooting for it to cast off its old ways. Airlines and other buyers depend on the fierce rivalry between Airbus and Boeing to foster development of new technologies and keep aircraft prices in check. "If Boeing would not do the industry well to let one of the jetmakers severely weakened," says John L. Plueger, president of Los Angeles-based International Finance Corp., one of Airbus' largest customers, with 10 A380s on order. "I think this is an incredible opportunity for Airbus to right the ship." ■

—With Stanley Holmes in Seattle and Gail Edmondson in Hamburg



**EX-CEO STREIFF**  
Airbus is still a  
"juxtaposition of  
four companies"

## Sharing the **Work**

How Airbus divvies up its plane-building

| GERMANY                                          | FRANCE                                      | BRITAIN                       | SPAIN              |
|--------------------------------------------------|---------------------------------------------|-------------------------------|--------------------|
| <b>21,500</b>                                    | <b>20,400</b>                               | <b>10,000</b>                 | <b>3,100</b>       |
| <b>EMPLOYEES</b>                                 | <b>EMPLOYEES</b>                            | <b>EMPLOYEES</b>              | <b>EMPLOYEES</b>   |
| Assembly of narrow-body planes; cabin outfitting | Corporate headquarters; A380 final assembly | Wing design and manufacturing | Tail manufacturing |

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## PETRO POLITICS

# IN ECUADOR, ONE SLIPPERY OIL PATCH

Oxy is out and PetroEcuador is in, but can the state company keep things flowing?

BY GERI SMITH

**S**IX MONTHS AGO, CARLOS Blum was an operations chief at Occidental Petroleum Corp.'s huge oil field in Ecuador's Amazon jungle—a plum job. Over its 21 years in the country, Oxy had become Ecuador's largest private oil producer, its most profitable company, and its biggest taxpayer. Oxy even won credit for hiring an anthropologist to maintain relations with the indigenous population. And thanks to high oil prices and Ecuador's profit-sharing laws, Blum and 300 fellow Oxy employees took home bonuses of more than \$200,000 apiece last year—on top of salaries that were already generous by local standards.

But on May 15, Ecuador booted Oxy out of the country. The government rescinded Oxy's contract, saying the company illegally transferred an interest in its fields to

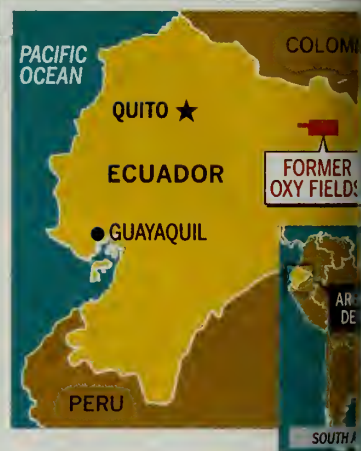
another company in 2000 without obtaining permission. Oxy disagrees and is seeking \$1 billion in damages. Meanwhile, the state-owned oil company, PetroEcuador, is scrambling to keep the crude flowing at more than 132 wells scattered across 770 square miles of jungle. And 50-year-old Blum, a six-year Oxy veteran who spent 19 years with Texaco and Halliburton, has suddenly found himself in charge of it all. "We're not trying to reinvent the wheel. We're just trying to sustain production," he says.

Ecuador is the third Latin American country this year to kick out foreign oil companies or demand a bigger cut of their profits. Venezuela led the way, hiking taxes and forcing companies such as Chevron Corp. and Royal Dutch Shell PLC to turn over control of their projects to the state oil company. Then Bolivia nationalized its oil and gas industry in May, shocking big investors such as Brazil's Petrobrás. Now Bolivia is having

trouble coming up with enough cash to run its fields.

Will Ecuador run into the same problems? Much could depend on the results of an election on Oct. 15 to elect Ecuador's eighth president in a runoff. Former Finance Minister Rafael Ángel Correa, 43, who holds a PhD in economics from the University of Illinois, is favored to win. An ally of Venezuelan President Hugo Chávez, he's calling for greater state control over the oil industry, higher royalties on foreign players. That could make Oxy's woes just the start of bigger troubles for foreign players in Ecuador.

PetroEcuador already has its hands full with the former Oxy fields, known as Block 15. Since PetroEcuador assumed control in May, production has fallen 4%, to 96,000 barrels per day. Blum says that's due to routine maintenance that output should bounce back. He is lining up two rigs to start work on 35







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TOGETHER, GREAT THINGS HAPPEN.



wells that Oxy planned to complete this year but barely started. PetroEcuador has also hired ex-Oxy employees on temporary contracts, paying them top salaries to keep them on board. And the government is creating a special unit inside PetroEcuador to run the former Oxy fields like a private enterprise. The goal, says Energy & Mines Minister Ivan Rodríguez, is to shield the operation from the “terribly corrupt” and inefficient practices of the company, which has suffered an oil spill every two days this year. “Block 15 will be an island,” he says. “We are doing things right there, with technically qualified people who are not politicized.”

If it can manage the operations, Ecuador stands to benefit handsomely. The former Occidental field, which accounts for nearly 20% of Ecuador’s output, holds some 522 million barrels of proven reserves. At current production

levels, that translates into nearly \$1.9 billion in gross annual revenues if crude prices stay at \$50 a barrel. A new law that requires companies to share revenues with the government when oil prices top \$22 a barrel will only

**Ecuador expects a windfall of \$950 million this year**

add to the take. The Ecuadoran treasury is expecting a windfall of \$950 million this year and around \$1.3 billion in 2007.

The question is whether PetroEcuador can keep the oil flowing. Oxy had planned to invest \$400 million in Block 15 this year—nearly double the \$221 million PetroEcuador expects to spend. That means the state company may not be able to pump as much as the Americans did. “Operating these fields requires working capital,” says Jed Bailey, senior research director for Latin America for Cambridge Energy Research Associates Inc. in Cambridge, Mass. “You need quite a lot of investment.”

A more pressing question for the 20 international players still operating in Ecuador is the attitude toward outsiders. That will be clearer after the election. With Oxy’s departure, Spain’s Repsol is now Ecuador’s No. 1 private producer but will “end up just breaking even” in 2006 because of the new tax regime, says country manager Carlos J. Arnao. Adds René Ortiz, president of the Hydrocarbons Industry Assn.: “Ecuador has lost a lot of its appeal for foreign companies.” ■

**OIL**

# LUKOIL: IT’S RUSSIAN FOR ‘FILL ‘ER UP’

An ambitious retail expansion in America is part of a plan to become a global giant

**BY JASON BUSH**

**T**HE RUSSIANS ARE COMING—to New Jersey. The strip of scruffy motels and gas stations on Route 4, just over the George Washington Bridge from Manhattan, is already home to Exxon, Sunoco, BP, and other brands. But lately an interloper from Eastern Europe has put up pumps next to those stalwarts of the commuter business. Lukoil, Russia’s top oil producer, has opened two stations on the strip, part of a U.S. expansion aimed at making its red-and-white logo an international icon and catapulting the company into the ranks of global oil giants.

It’s a story that has been playing out across the northeastern U.S. Since 2000, when Lukoil bought Getty Petroleum Marketing Ltd., it has quietly built a gas station empire stretching from Maine to Virginia. Lukoil owns some 2,000 outlets and aims to acquire up to 1,000 more. So far, 400 stations carry the Lukoil logo, and the goal is to rebrand them all by 2008. Lukoil has 7% of the market across the 13 states where it operates, and in New Jersey and Pennsylvania its share is 24%.

Lukoil is already Russia’s top oil player. It earned \$6.4 billion on revenues of \$56.2 billion in 2005, with profits per barrel some 30% higher than at No. 2 Rosneft. Even as the Kremlin has asserted control over energy, Lukoil has remained independent. That’s a testament to the po-

litical and business acumen of Lukoil president and founder, Vagit Alekperov. President Vladimir V. Putin even blessed the union with ConocoPhillips (page 94) as a 19% shareholder in Lukoil. “I have a strategy to create global energy companies,” says Julia Nanay, an analytical Washington consultant PFC Energy.

The U.S. is a key part of Alekperov’s global design. On Oct. 18 in New York, Lukoil is set to unveil a 10-year development plan. Although details are sketchy, Lukoil plans to invest \$100 billion, including some \$20 billion in refineries and gas stations, and double output. “The future of Lukoil is in two markets: America and China,” says Leonid Fedun, vice-president for strategic development.

Can Lukoil pull it off? One key market is Lukoil’s rich assets in Russia’s north, where it is working on a field that could produce 200,000 barrels per day by 2009. The plan is to ship that crude to the U.S. for refining and sale. Although Lukoil doesn’t yet own a U.S. refinery, Fedun says they’re too pricey now—the company hopes to buy one eventually. Says Fedun: “We’re planning to approach the level of the world’s major energy companies.” ■

**GAS AND GO** Lukoil owns some 2,000 outlets, with 1,000 more on the way



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## **PREETE GANDHI NEEDED MORE IMMEDIATE GRATIFICATION.**

Researching new cancer medicines at Pfizer Inc. was important work, yes. But she knew bringing a new drug to market could take more than a decade. So in 2002, Gandhi, then a 26-year-old chemistry graduate from Ohio State University, began planning for a business career. An MBA seemed a logical first step, and the University of Chicago Graduate School of Business, with its outsize reputation and world-class faculty, looked like a good bet.

The school did not disappoint. When she arrived, Gandhi found a new building that included an Italian-style piazza where students and faculty congregate and swap ideas. And a spark plug of a dean named Edward A. Snyder was busily figuring out ways to challenge students as they had never been challenged before. One of the aspects of the Chicago program that Gandhi appreciated the most was the opportunity for first-year students to take advanced courses, allowing less experienced students like her to get more attention in the introductory classes. Gandhi selected finance, strategy, and marketing classes, which allowed her to prepare for a summer internship at Abbott Laboratories.

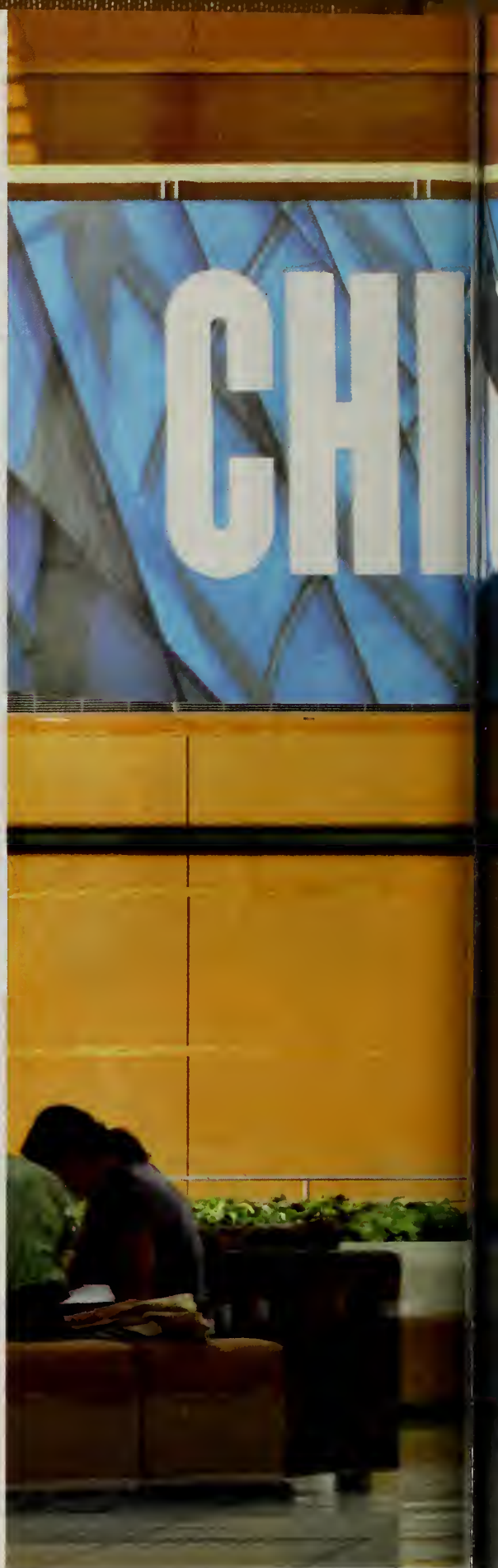
Before entering the Chicago program, Gandhi's knowledge of finance was limited to balancing her checkbook. By the

# The Best B Schools

Our exclusive survey ranks the top MBA programs by measuring student and recruiter satisfaction. And, for the first time, Chicago came out on top.

**BY LOUIS LAVELLE**

MICHAEL L. ABRAMSON





**NO. 1**  
Students at Chicago  
give Dean Snyder's  
reforms an A+



# TheBestB-Schools

time she left, she was skilled enough in the finer points of finance that she received lucrative offers from Abbott Labs, Deloitte Consulting, and Washington Mutual. She ultimately accepted a position as senior financial analyst at Microsoft, where her compensation is about \$100,000, double what she was making at Pfizer. Says Gandhi: "If I can come in as a scientist and leave working in finance for a tech company, that's a statement in itself."

It also helps explain why Chicago, for the first time, has vaulted to the top of *BusinessWeek's* 2006 biennial survey of

the world's best business schools. Chicago has always held an esteemed place in the *BusinessWeek* rankings, landing in the top five a half-dozen times since the rankings began in 1995. After all, the B-school has an award-winning faculty that includes a winner of the MacArthur "genius" grant, Kevin Murphy, and two Nobel prize winners, plus an alumni network that includes the former chief executive officers of Goldman Sachs, Morgan Stanley, and Merrill Lynch. But its reputation with students has always been uneven; the school scores well with those seeking a rigorous analytical program but low

## The Best B-Schools of 2006

For the Class of 2006, things couldn't be better. Among the top 30 schools, job offers were up 20% over 2004, to an average of 2.3 per graduate. And the average salary is up more than \$8,000, or 9.7%, to \$95,000, with grads from nearly a third of the schools now raking in six-figure paychecks. After three years in the doldrums, even applications are up, with nearly two-thirds of all full-time programs seeing a boost, compared with 21% in 2005.

Tuition and fees were up 15% across the board, with the typical two-year cost for a top 30 program up more than \$10,000 since 2004. Enrollment of women and minorities continued to advance, but just barely. They now account for 29.2% and 9.8% of students in the top 30, respectively, up from 28.5% and 9.6%.

The letter grades are based on survey responses from grads at 73 U.S. schools and MBA recruiters at 223 companies. The top 20% in each category earned A+s. The next 25% got As, the next 35% got Bs, and the bottom 20% received Cs.

| 2006 RANK | SCHOOL                         | 2004 RANK | CORP. POLL | GRAD. POLL | INTEL-LECT. CAPITAL | ANNUAL TUITION <sup>1</sup> | % APPLICANTS ACCEPTED | ENROLLMENT <sup>2</sup> | WOMEN | IN |
|-----------|--------------------------------|-----------|------------|------------|---------------------|-----------------------------|-----------------------|-------------------------|-------|----|
| 1         | Chicago                        | 2         | 3          | 1          | 9                   | \$42,182                    | NR                    | 31%                     | 30    | 30 |
| 2         | Pennsylvania (Wharton)         | 3         | 2          | 4          | 8                   | 44,795                      | 21                    | 32                      | 4     | 30 |
| 3         | Northwestern (Kellogg)         | 1         | 1          | 2          | 23                  | 41,115                      | 24                    | 31                      | 2     | 30 |
| 4         | Harvard                        | 5         | 4          | 8          | 7                   | 46,056                      | 15                    | 35                      | 3     | 30 |
| 5         | Michigan (Ross)                | 6         | 5          | 10         | 16                  | 42,024                      | 28                    | 34                      | 3     | 30 |
| 6         | Stanford                       | 4         | 10         | 3          | 5                   | 43,380                      | 10                    | 32                      | 4     | 30 |
| 7         | MIT (Sloan)                    | 9         | 9          | 5          | 6                   | 42,364                      | 20                    | 31                      | 3     | 30 |
| 8         | UC-Berkeley (Haas)             | 17        | 7          | 7          | 11                  | 36,634                      | 18                    | 35                      | 3     | 30 |
| 9         | Duke (Fuqua)                   | 11        | 8          | 9          | 4                   | 39,350                      | 36                    | 29                      | 3     | 30 |
| 10        | Columbia                       | 8         | 6          | 16         | 13                  | 40,948                      | 17                    | 35                      | 4     | 30 |
| 11        | Dartmouth (Tuck)               | 10        | 15         | 12         | 2                   | 40,903                      | 20                    | 33                      | 3     | 30 |
| 12        | UCLA (Anderson)                | 14        | 17         | 15         | 1                   | 36,094                      | 29                    | 28                      | 3     | 30 |
| 13        | Cornell (Johnson)              | 7         | 16         | 14         | 3                   | 38,800                      | 36                    | 24                      | 3     | 30 |
| 14        | NYU (Stern)                    | 13        | 12         | 11         | 25                  | 39,600                      | 22                    | 40                      | 3     | 30 |
| 15        | Virginia (Darden)              | 12        | 14         | 6          | 35                  | 41,000                      | 41                    | 21                      | 2     | 30 |
| 16        | Carnegie Mellon (Tepper)       | 15        | 13         | 20         | 20                  | 42,288                      | 29                    | 21                      | 2     | 30 |
| 17        | North Carolina (Kenan-Flagler) | 16        | 18         | 18         | 10                  | 36,383                      | 47                    | 27                      | 2     | 30 |
| 18        | Indiana (Kelley)               | 18        | 11         | 21         | 31                  | 30,458                      | 40                    | 27                      | 4     | 30 |
| 19        | Yale                           | 22        | 26         | 13         | 28                  | 42,685                      | 22                    | 38                      | 2     | 30 |
| 20        | Texas-Austin (McCombs)         | 19        | 19         | 24         | 27                  | 36,200                      | 37                    | 29                      | 2     | 30 |
| 21        | USC (Marshall)                 | 27        | 28         | 19         | 30                  | 39,000                      | 36                    | 35                      | 2     | 30 |
| 22        | Georgetown (McDonough)         | 25        | 22         | 23         | 34                  | 36,000                      | 41                    | 38                      | 3     | 30 |
| 23        | Emory (Goizueta)               | 20        | 36         | 17         | 15                  | 37,826                      | 34                    | 27                      | 3     | 30 |
| 24        | Purdue (Krannert)              | 21        | 20         | 26         | 17                  | 30,310                      | 42                    | 16                      | 4     | 30 |
| 25        | Maryland (Smith)               | 28        | 38         | 22         | 12                  | 36,444                      | 39                    | 28                      | 3     | 30 |
| 26        | Notre Dame (Mendoza)           | 24        | 21         | 32         | 32                  | 34,045                      | 49                    | 20                      | 2     | 30 |
| 27        | Washington University (Olin)   | 23        | 29         | 27         | 29                  | 36,655                      | 54                    | 29                      | 3     | 30 |
| 28        | Rochester (Simon)              | 29        | 25         | 28         | 24                  | 39,711                      | 36                    | 28                      | 4     | 30 |
| 29        | Michigan State (Broad)         | NA        | 27         | 31         | 21                  | 25,046                      | 33                    | 31                      | 3     | 30 |
| 30        | Vanderbilt (Owen)              | 30        | 32         | 25         | 33                  | 39,249                      | 44                    | 26                      | 2     | 30 |

1. 2005-06 (where applicable, out-of-state figures used). 2. For combined years 2005-2006; minority figure does not include Asian-Americans. 3. Salary only. 4. Based on 2006 recruiter survey. 5. Based on 2006 student survey. NR, No response. NA, Not applicable. Data: *BusinessWeek*, Cambria Consulting



looking for an emphasis on teamwork. Snyder's reforms, which include weekly breakfasts with students and improved career services for them, seem to have made the difference. The changes at Chicago reflect a broader reappraisal of curricula at B-schools around the country. For three years, MBA programs have been plagued by declining applications in a lukewarm market for MBA talent, and an epic bout of soul-searching over the value of the degree. Critics inside and outside the academy have criticized the standard B-school curriculum as at best irrelevant and at worst seriously

misguided. Recruiters, who in another era would have gladly plunked down more than \$100,000 for a top B-school grad, had been getting restless, claiming many lacked basic management skills. With the very future of the degree in doubt, many schools have been forced to make their programs mesh better with the demands and complexities of the real world.

Today the MBA is on the road to recovery. True, demand for the degree is a long way from the 2002 peak. But after a three-year decline, applications to full-time programs surged in 2006. In all, nearly two-thirds of schools that responded to a survey

| RANK | SCHOOL | % RESPONDENTS<br>W/OFFER BY<br>GRADUATION | AVG. WORK<br>EXPERIENCE<br>(MONTHS) | DESCRIPTIONS                                                                                                                                                        | RECRUITER GRADES <sup>6</sup> |               |                    | MBA GRADES <sup>7</sup> |                    |
|------|--------|-------------------------------------------|-------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------|---------------|--------------------|-------------------------|--------------------|
|      |        |                                           |                                     |                                                                                                                                                                     | COMMUNIC-<br>ATION            | TEAM-<br>WORK | ANALYTIC<br>SKILLS | TEACHING<br>QUALITY     | CAREER<br>SERVICES |
| 95.0 |        | 96.9                                      | 62                                  | Students appreciate option to tailor curriculum to their interests. Living in Chicago gets pricey, but most say facilities and faculty are worth the expense.       | A                             | A             | A+                 | A+                      | A+                 |
| 95.0 |        | 97.1                                      | 71                                  | Students say competitive program improves the academic experience. Decision to allow students to disclose grades to recruiters has many disconcerted.               | A+                            | A             | A+                 | B                       | A+                 |
| 90.0 |        | 95.9                                      | 62                                  | The word used over and over by Kellogg students is "collegial." School balances individual development and teamwork, case studies and lectures.                     | A+                            | A+            | A+                 | A                       | A+                 |
| 95.0 |        | 96.6                                      | 54                                  | Case method allows students to solve real-world problems. Ivory tower is not everyone's cup of tea, but alumni network is vast.                                     | A+                            | B             | A+                 | A+                      | A+                 |
| 95.0 |        | 94.8                                      | 64                                  | Lack of grades diminishes competition and increases focus on work. Facilities are lacking but undergoing a makeover.                                                | A+                            | A+            | A+                 | B                       | A                  |
| 90.0 |        | 99.3                                      | 48                                  | With Silicon Valley around the corner, innovation reigns. Extensive electives cater to students with interests beyond banking and consulting.                       | A+                            | B             | A+                 | B                       | A+                 |
| 90.0 |        | 96.3                                      | 57                                  | MIT offers unique courses with entrepreneurial focus and attracts students with engineering backgrounds. Prominent faculty remains accessible.                      | B                             | B             | A+                 | A                       | A                  |
| 90.0 |        | 94.8                                      | 67                                  | Tech and entrepreneurial specialties give Haas grads an edge in innovation. Curriculum is not as well-suited for those with eyes set on Wall Street.                | A                             | A             | A                  | B                       | A                  |
| 95.0 |        | 93.4                                      | 70                                  | Students on "Team Fuqua" enjoy the collaborative learning experience. Good for the hand-holding types, but some would like more debate and conflict.                | A+                            | A+            | A+                 | A+                      | A+                 |
| 90.0 |        | 94.3                                      | 60                                  | Students appreciate vast alumni network and high-profile speakers. Access to recruiters for everything from international companies to lesser-known employers.      | A+                            | A             | A+                 | B                       | A                  |
| 90.0 |        | 91.8                                      | 68                                  | Small class, small town leaves something to be desired. But many appreciate the "self-selecting" crowd that attends. General management program is specialized.     | A                             | A+            | A                  | A+                      | A                  |
| 95.0 |        | 90.1                                      | 57                                  | Students go by an "excellence without attitude" mantra. Active student clubs provide career development, but there's limited access to East Coast recruiting.       | A                             | A             | A                  | B                       | B                  |
| 95.0 |        | 97.1                                      | 59                                  | Particularly popular among career switchers, Cornell offers small class size and accessible professors. Students enjoy new immersion-learning programs.             | A                             | A+            | A                  | A                       | A                  |
| 95.0 |        | 91.7                                      | 59                                  | Local alumni base is large, and former students are willing to lend a hand in the job search. Good for career switchers.                                            | A                             | A+            | A                  | A+                      | A+                 |
| 95.0 |        | 96.3                                      | 61                                  | Case method works well in small classes that foster Socratic learning. Students get individual attention from administration and faculty.                           | A+                            | A+            | A                  | A+                      | A+                 |
| 95.0 |        | 94.9                                      | 52                                  | Tepper's small class size creates intense focus, intimacy, and greater hands-on responsibility. Curriculum is geared toward the quantitatively analytical mind.     | C                             | B             | B                  | A                       | B                  |
| 90.0 |        | 93.0                                      | 64                                  | Job placement leaves most grads smiling, but international students may not have the same luck. Extracurricular activities and pleasant location add to the appeal. | A                             | A             | A                  | A+                      | B                  |
| 87.0 |        | 87.5                                      | 63                                  | Kelley is praised for general education but is found lacking in specialties like consulting and investment banking. Strong regional bias limits recruiting options. | A                             | A+            | A                  | A+                      | B                  |
| 95.0 |        | 95.5                                      | 58                                  | Small program size means easy access to alumni and faculty. Students applaud new dean Joel Podolny, cited for being a visionary leader.                             | A                             | A             | B                  | A                       | A                  |
| 90.0 |        | 88.9                                      | 60                                  | Complaints include unresponsive administration and poor career placement for international students. Variety of classes and other resources balance equation.       | A+                            | A+            | A                  | C                       | B                  |
| 89.0 |        | 87.4                                      | 62                                  | Strong community and alumni network offer lifelong career contacts. Drop in 2004 rankings led to major program overhaul, but students want further improvements.    | B                             | B             | B                  | C                       | A                  |
| 90.0 |        | 90.3                                      | 62                                  | D.C. area offers students many opportunities for work in the public sector and international business. Demanding classes are taught by diligent professors.         | C                             | C             | B                  | A                       | B                  |
| 90.0 |        | 91.9                                      | 59                                  | Students extol leadership development, accessible professors, and caliber of classmates. One-year program offers a popular alternative to two-year MBA.             | B                             | C             | B                  | A                       | A                  |
| 95.0 |        | 93.3                                      | 55                                  | Students laud financial aid offerings and diverse, international student population. Curriculum emphasizes quantitative skills and teamwork.                        | B                             | C             | B                  | B                       | B                  |
| 95.0 |        | 85.9                                      | 60                                  | Smith grads gripe about regional recruiting and inadequate career services. But tight-knit community and affordable tuition help ease the strain.                   | C                             | C             | B                  | C                       | C                  |
| 95.0 |        | 80.2                                      | 52                                  | Students miss proximity to big city but enjoy the tight-knit community and finance training. Recent switch from semesters to a 7-week system gets mixed reviews.    | B                             | B             | C                  | C                       | B                  |
| 95.0 |        | 92.0                                      | 52                                  | Small class size means personal attention from faculty, but on-campus recruiting is a disappointment. Campus hosts a noteworthy leadership speaker series.          | C                             | B             | B                  | A                       | C                  |
| 83.0 |        | 82.6                                      | 55                                  | Quality of education, analytical skill development, and personal attention from faculty is highly rated, but poor showing by recruiters frustrates students.        | A                             | A             | A                  | A                       | B                  |
| 95.0 |        | 96.1                                      | 60                                  | Teamwork focus means most grades are based on group, rather than individual, performance. Students praise outstanding career services center and faculty.           | C                             | B             | C                  | B                       | A                  |
| 87.0 |        | 92.2                                      | 55                                  | Students applaud the overall experience at Owen. Grads say that rigorous curriculum leaves them well-equipped for future careers.                                   | B                             | A             | B                  | B                       | B                  |

options, or other compensation. Based on respondents to student survey; does not represent entire graduating class. 4. Based on respondents to student survey. 5. Supplied by schools.



# TheBestB-Schools

by the Graduate Management Admissions Council reported an increase, compared with just 21% in 2005. And MBA grads are winning lofty pay packages not seen since the bubble years of the late 1990s. "The job market for MBAs is the strongest it's been in many years," says Steve Canale, General Electric Co.'s top recruiter. "Supply is tight, and demand is up. It's Economics 101."

The best-ranked programs from previous years continue to dominate the top of the list. The University of Pennsylvania's Wharton School, which moved up a notch, to No. 2, did so on

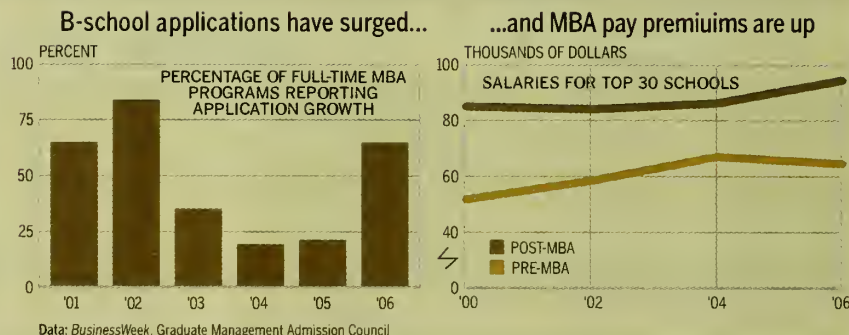
Recruiters, meanwhile, were wowed by the quality of g Adobe Systems Inc., the San Jose (Calif.) software m found more than a third of its MBAs at Haas this year. " produces very strong, entrepreneurial, innovative-type t ers," says Michelle A. Smith, Adobe's manager of univ recruiting. "They fit well with our culture and are able t laborate effectively."

Berkeley's performance this year shows that, when it c to career services, sweating the small stuff is key. Several

ago, Haas became one of the fir schools to assign "account manage work directly with individual recru One was even dispatched to New to strengthen Haas's relationship the big financial services comp In addition, recruiters who visi campus now get VIP treatment. I is on the school, and Dean Tom C bell frequently drops by to ask wh school could be doing better. Pa permits for recruiters are now issu advance, or someone from the s meets recruiters curbside with a p in hand. Abby Scott, the school's e tive director of MBA career services recruiters who'd begun skipping are starting to return.

Indeed, recruiters are noticing the changes. Hie DeShields, manager of corporate talent acquisition for Saf Inc., says her Haas account manager helped rewrite Safe job postings to make them more attractive and identifed dents who might be a good fit. "She wasn't passive in t of just posting our opportunities," says DeShields, who four of her 11 offers at Haas this year. "She was an advoca our business."

## In the Money



the strength of its core curriculum and extensive elective offerings, as well as unusual approaches to teaching. One program, for example, teaches leadership as students climb a volcano in Ecuador. And even though Northwestern University's Kellogg School of Management lost its grip on the No. 1 perch it has held since 2002, it fell only two places, to No. 3. Kellogg continues to win student plaudits for its rigorous academics, top-flight student body, and support from faculty and career services that one grad called "almost parental."

Fresh thinking from business school deans has also allowed several programs to move up in the rankings. Case in point: the University of California at Berkeley's Haas School of Business, which until now had never broken into the top 10. Haas catapulted nine spots, to No. 8, leapfrogging such perennial favorites as Cornell, Columbia, and Dartmouth. The combination of a small class, exceptional faculty, and a collegial atmosphere impressed students. "What I was looking for in a school was getting a real learning experience, not just getting my ticket punched," says Anders Geertsen, who is pursuing a banking career. "The students at Berkeley are there to learn and connect to one another."

## BACK IN BUSINESS

Applica  
recruiters is he

The market for MBA talent is subject to the same laws o ply and demand that roil the business world. With the eco in turmoil following the dot-com bust, B-school applica swelled, and two years later graduates flooded the m driving down salary offers. But as the economy improve applications began to skid, the result has been fewer MB

up and coming

down and out





**STRONG SECOND**  
Wharton scores high  
with a solid core and  
inventive approach

market this year. And you know what that means: plenty of competition for talent and, yes, bigger paychecks. More graduates have been flooding in, giving grads more choices than in previous years. Among the Top 30 schools, grads received on average 1.7 more than two offers apiece, up 20% over the previous year. And the number of students without a solid job offer by graduation has declined dramatically. One survey by WetFeet, a San Francisco research company, found that half of the

which includes signing bonuses and other pay, is even higher. Based on preliminary 2006 data from schools, graduates of Babson College, Vanderbilt University, and the University of Michigan all saw double-digit increases over 2004, with median total compensation for Michigan grads topping out at \$130,000. One Chicago grad surveyed by *BusinessWeek* had seven offers by graduation, and ultimately took a job as a research analyst at an asset management company. Estimated first-year compensation: an impressive \$195,000.

## the rise, demand from and many starting salaries now top six figures

As of 2002 grads were still looking for work in May of that year, only 14% were. More graduates of top schools who answered our survey, the typical salary is up more than \$8,000, or 9.7% over 2004, to \$88,000. And the typical grad at nearly a third of those programs now rakes in a six-figure paycheck. Total compensation,

For recruiters, a tight market for MBA talent calls for a change in tactics. With more recruiters on campus, and individual students receiving more offers, talent scouts have to work harder to stand out. With new recruits at PriceWaterhouseCoopers receiving at least twice as many offers as last year, PwC has launched a branding campaign to put their name front and center on college campuses. At on-campus recruiting events, JPMorgan Chase & Co., which hired 85 MBAs this year, will trot out alumni who work at the company and

JENNIFER S. ALTMAN

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have risen through the ranks. The message: The company is a true meritocracy where hard work is rewarded. The pitch works, but even so, the competition for the best students makes for a difficult recruiting environment, says JPMorgan recruiter Danielle Domingue. "This definitely feels like the feeding frenzy of 2000," Domingue says. "The students just have more choice."

While the news about the market for MBA talent is almost uniformly good, B-school deans and faculty are not standing still. Many are embarking on some of the most ambitious curriculum reforms in recent memory. Deans around the country have recognized that traditional programs compartmentalized by discipline no longer match the "flat" structure currently in vogue at American companies. What's more, managing has become ever more complex: On any given day, executives must analyze information from all corners of the globe in real time, and coordinate resources across borders and time zones.

Seven of the top 30 programs are planning or undergoing massive curriculum overhauls designed to churn out more

competent grads. And at least that many are innovating around the edges, developing new programs or courses shifting focus. The changes vary in direction and scope, but many share a common goal: to turn out graduates able to grapple with the competing priorities that managers confront every day and execute on a plan with little or no input from higher-ups. Today, recruiters say, many grads, weaned on a steady diet of cut-and-dried case studies, are incapable of deciding on a pricing strategy or a marketing approach in the face of unknowns—everything from consumer reaction to the price of oil. And worse: They can't follow through on a plan once it's been made. Having spent two years in B-school working on teams, where everyone and no one is in charge, they don't have the leadership and communication skills they need to take a project from start to finish. Theoretically, new programs now in the works will create stronger decision makers, better problem solvers, more effective communicators—in a word: leaders.

While such overhauls happen with some regularity, m

## The High Price of Admission

This year both the costs and benefits of attending B-school surged. For our top 30 schools, tuition and fees alone were up 15% on average, and the price tag for a Wharton MBA now approaches \$90,000, up nearly \$20,000 since 2004. Good thing salaries for grads increased, too. 2006 MBAs could expect first-year paychecks of about \$95,000 on average, an increase of 47% from their pre-MBA days and a huge increase over the 29% MBA pay premium that 2004 grads received. But in narrow economic terms, it may not pay to attend one of the top-ranked schools; a midtier school is a better bet. That's because the likes of Wharton and Harvard tend to attract high earners, making it harder to get a big salary bump at graduation and recoup the investment in an MBA. How hard? For Harvard grads, the break-even point won't come until 2020, or about 20 years shy of retirement.

### FASTEST RETURN

| RANK | SCHOOL                       | AVERAGE COST | SALARY PREMIUM | YEARS TO BREAK EVEN |
|------|------------------------------|--------------|----------------|---------------------|
| 1    | BYU (Marriott)               | \$133,234    | \$35,068       | 3.80                |
| 2    | Michigan State (Broad)       | 161,905      | 40,805         | 3.97                |
| 3    | South Carolina (Darla Moore) | 165,283      | 37,675         | 4.39                |
| 4    | Wisconsin (Madison)          | 186,800      | 42,343         | 4.41                |
| 5    | Buffalo                      | 109,154      | 21,840         | 5.00                |
| 6    | Notre Dame (Mendoza)         | 190,241      | 37,652         | 5.05                |
| 7    | Rochester (Simon)            | 199,447      | 38,569         | 5.17                |
| 8    | University of Washington     | 193,627      | 36,795         | 5.26                |
| 9    | Emory (Goizueta)             | 225,737      | 42,472         | 5.32                |
| 10   | Washington U. (Olin)         | 205,518      | 36,399         | 5.65                |

### SLOWEST RETURN

|    |                        |           |          |       |
|----|------------------------|-----------|----------|-------|
| 1  | Chicago                | \$289,474 | \$28,692 | 10.09 |
| 2  | Babson (Olin)          | 236,821   | 23,319   | 10.16 |
| 3  | Dartmouth (Tuck)       | 289,634   | 28,404   | 10.20 |
| 4  | Northwestern (Kellogg) | 289,055   | 27,182   | 10.63 |
| 5  | Columbia               | 315,780   | 26,610   | 11.87 |
| 6  | UC Berkeley (Haas)     | 291,805   | 24,240   | 12.04 |
| 7  | Pennsylvania (Wharton) | 328,748   | 25,775   | 12.75 |
| 8  | Harvard                | 345,401   | 23,921   | 14.44 |
| 9  | Stanford               | 328,062   | 22,351   | 14.68 |
| 10 | MIT (Sloan)            | 324,305   | 21,500   | 15.08 |

Data: BusinessWeek. Note: Domestic schools only. Schools with fewer than 50 survey responses excluded from analysis. Total cost includes two years' tuition, fees, student-reported living expenses, and forgone pre-MBA salary. Salary premium based on student-reported pre- and post-MBA salaries only; does not include signing or performance bonuses, annual pay increases, stock options, or other compensation.



Ohio's business opportunities  
didn't surprise Tim Tsao.  
The sailing opportunities  
were another story.

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he'd been.

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## TIM TSAO'S STORY

"I love the sense  
of ownership  
and individual  
opportunity I've  
found in Ohio."

Tim Tsao  
Vice President, Sales & Marketing  
Kahiki Foods, Inc.

Tim Tsao grew up in Ohio, but his technology and marketing career took him to D.C., San Francisco and New York. It was the opportunity to use his expertise to help guide his family's business to prominence that brought him back. Though the famous Kahiki Restaurant had closed its doors, Tim and the Kahiki management team kept its rich heritage alive by bringing to market premium quality frozen foods. Aided by creative financial assistance from the city and state, and using lean manufacturing techniques while never sacrificing quality, Kahiki Foods quickly grew to \$25 million in sales last year and moved into its custom 119,000 square foot facility. Business is good.

Still, in his years away, Tim had developed a passion for competitive sailing that he refused to compromise. Much to his delight, he found a thriving championship-caliber sailing community in the heart of Ohio and now races twice a week with his local club. Sailing wasn't the only "big-city" amenity Tim found in Ohio. In fact, he believes Ohio has all New York has on a smaller, affordable scale. Life is good.

Personally and professionally, Tim's return to Ohio has been great for him, his family and his career.

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at lower-tier schools seeking a competitive advantage, top-ranked schools are leading the charge now. This summer, Stanford University's Graduate School of Business, ranked at No. 6, scrapped its one-size-fits-all curriculum and introduced a new model that emphasizes flexibility and customization. Tailored to students' individual education, work experience, and goals, courses offered starting next fall will challenge students to understand more than one academic discipline or managerial function and develop the critical thinking skills they'll need to make decisions when information is sketchy and risks are high. In a course called "Critical Analytical Thinking," students will analyze questions such as what responsibilities com-

panies have to society, and develop the communication skills they need to persuade others of their positions. "This is a curriculum reform for us," says Garth Saloner, a management professor who headed the committee that recommended changes. "If you could start with a blank sheet of paper, what program would you put in place that would put your school in the best position to manage organizations? That's what we really want to do."

The centerpiece of the new curriculum at the No. 1 ranked Yale University School of Management is a series of eight courses drawing on the insights of multiple management disciplines to solve vexing problems. One example is a

## How We Come Up With the Rankings

Since 1988, *BusinessWeek* has published its Best B-schools ranking every other year as a way to help prospective students find suitable MBA programs. Over the years, we've nearly tripled the size of the report, added new schools, and updated our methodology. Through all of this, the ranking has centered on one thing: customer satisfaction. We measure this by surveying not just thousands of students but the corporate recruiters who hire them.

This year, we sent a 50-question survey to 16,565 Class of 2006 MBA graduates at 100 schools in North America, Europe, and Asia. Overall, we received 9,298 responses, the same 56% response rate as in 2004. Nearly every school helped us contact grads, though the Harvard Business School and the University of Pennsylvania's Wharton School declined to provide student contact information. Using publicly available sources, we were able to reach nearly 39% of the Class of 2006 at those two schools, a significantly lower number than the overall response rate, but enough to make the findings statistically valid.

On the Web-based student survey, grads were asked to rate everything from teaching quality to the effectiveness of career services at their schools on a scale of 1-10. The Class of 2006 graduate survey results count for 50% of a school's total student satisfaction score. An additional 25% comes from the responses of 11,518 graduates in the 2002 poll and 25% from 10,074 graduates polled in 2004. Measuring

six years' worth of data ensures that short-term improvements or problems don't sway the results. To eliminate outliers, 19 schools were removed from ranking consideration due to low response rates.

Next we asked David M. Rindskopf and Alan L. Gross, professors of educational psychology at City University of New York Graduate Center, to analyze the data. The idea was to ensure that the results were not skewed by any attempts to

### By the Numbers

| GRADUATE POLL  | 2002   | 2004   | 2006   |
|----------------|--------|--------|--------|
| Surveys        | 16,906 | 18,052 | 16,565 |
| Replies        | 11,518 | 10,074 | 9,298  |
| Response Rate  | 68%    | 56%    | 56%    |
| RECRUITER POLL |        |        |        |
| Surveys        | 420    | 456    | 426    |
| Replies        | 219    | 223    | 223    |
| Response Rate  | 52%    | 49%    | 52%    |

influence student responses or otherwise affect the outcome. They tested the responses to verify credibility of the data to guarantee the poll's integrity. Once the student poll data was certified, the scores received a 45% weight in the overall ranking.

We also invited corporate MBA recruiters to fill out an online survey similar to that of the student survey. Of the 426 companies surveyed, 223 answered, for a response rate of 52%—up from 49% in 2004. Among the companies

were those that hire anywhere from a few MBAs each year to those that hire hundreds. Except in rare instances, each company was allowed to complete one survey as a way to make sure the results would not be distorted.

Recruiters were asked to rate their top 20 schools according to the quality of a B-school's grads and their company's experience with MBAs past and present. Companies could only rate schools at which they have actively recruited—on campus or off—in recent years. Each school's total score was divided by the number of responding companies that recruited from the school.

Because there tend to be greater differences among schools in the corporate survey than in the student poll, recruiter opinion can have a bigger impact on the overall ranking. To add depth and breadth to our recruiter survey, *BusinessWeek* this year added another improvement. Instead of basing each school's recruiter score on a single survey, as we have in prior years, we combined the three most recent polls, as we do with the student surveys. The 2006 recruiter survey counts for 50% of the recruiter score, while the 2004 and 2005 surveys contribute 25% each. Combine the three recruiter polls accounted for 45% of the final ranking. Another 23 schools with poor response rates in the recruiter survey were eliminated at this stage of the ranking.

Finally, we calculated each school's intellectual-capital rating by tallying faculty members' academic journal entries in 20 publications, from the *Journal of Accounting Research* to the *Harvard Business Review*. We also searched *The New York Times*, *The Wall Street Journal*, and *BusinessWeek*, adding points if a professor's book was reviewed there. The scores were then adjusted for faculty size. The final intellectual-capital score accounts for 10% of a school's final grade.



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...ach to the customer relationship, from a company's first contact with a prospective customer, usually in a marketing campaign, to the last, when the company loses the customer to a competitor—and everything in between, including customer service. Instead of treating the customer relationship as a marketing problem, as most MBA curriculums do now, they will treat it as an accounting problem, an economics problem, an organizational design problem, a psychology problem—and a marketing problem. A course that blends these disparate approaches might discuss how consumers behave, how to identify and keep the most profitable customers, and how to redesign the organization itself so that

customer feedback gets channeled back into product design. "Everybody's wrestling with how do we bring management education in line with the demands of management," says Yale Dean Joel M. Podolny. "Everybody recognizes there has to be some changes to the standard curriculum." Similar efforts are under way at Michigan, the University of Rochester, the University of North Carolina at Chapel Hill, Notre Dame, and Kellogg.

Columbia, which ranks No. 10, has a new MBA offering called the Program for Social Intelligence that borrows freely from the management playbooks of such corporate giants as General Electric and Goldman Sachs. The program includes more than a dozen activities—from a brainstorming exercise to a marketing plan simulation—making use of existing study teams to teach lessons on team dynamics. It also includes activities designed to help develop leadership skills and workshops on managing large organizations. "In developing these leadership skills, you don't learn it in a group of 60 or 100," says Michael W. Morris, the management professor who runs the new program. "You learn it by having experiential exercises in small groups and getting results you can interpret with the help of a coach."

Of course, the MBA revival has as much to do with the ebb and flow of the economy as it does the ongoing reform efforts at the nation's B-schools. But many deans are grateful that the *storm and drang* of recent years got them thinking about how to build a better manager. They recognize that a reassessment is long overdue and vital if the MBA is to remain relevant for the next generation of business leaders. ■

—With Paula Lehman in New York

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# AND FOR ACT II?



## Go to the Head Of the Class

A crash course aims to get executives ready to teach. **BY JOHN DEBRUICKER**

**THREE YEARS AGO, THE ASSOCIATION TO ADVANCE COLLEGIATE** Schools of Business (AACSB) sounded a warning to its accredited schools around the world. A cancer was eating away at the heart of the nation's MBA programs—a looming shortage of PhD-qualified faculty so severe that the future of graduate business education was at stake. With the number of business doctorates dwindling, the B-school establishment was facing a future of faculty vacancies, overcrowded classrooms, and declining quality.

As AACSB saw it, B-schools had to promote, fund, and generally pay more attention to their PhD programs, or else. This was a tall order, and still is. MBA programs are among the most lucrative on campus, and, as a result, receive the lion's share of resources, while PhD programs are a financial drain. With MBA enrollment at an all-time high, demand for faculty is growing. New business doctorates have declined, down to 907 in 2004 from 973 in 2000. And more than a third of all newly minted business PhDs never enter the academic job market.

AACSB now has an answer, but it's by no means a silver bullet. The organization's Bridge Program, which makes its debut Oct. 22, is a five-day crash course to certify senior executives to teach in MBA programs. AACSB President and CEO John

to teach before spending at least one semester observing the back row. Dean Albert W. Niemi Jr. says the Bridge Program alumni will be no exception: "That would be a huge mistake."

Even for the most highly motivated executives, the transition to academia isn't easy. Robert D. Rogers, who taught strategy and organizational behavior at Cox from 2000 to 2004, he was president and CEO of Texas Industries Inc., a near-billion supplier of building materials, hadn't set foot in a classroom since his days at Harvard 40 years before. The student body was a revelation—one student he flunked for not showing up sued him, unsuccessfully—and the amount of prep time required was a surprise. Says Rogers: "It was a lot of work."

By making it easier for schools to find qualified executives to teach, the Bridge Program might shift the focus of B-school curriculums from theory to practical knowhow. This is especially true among lesser-ranked institutions, which lack the resources to compete for top faculty and might rely more heavily on executives. For some the shift in focus is not a bad thing; neither is it an unalloyed good. It would dilute the very things that make American-style management education unique, namely its focus on conceptual and analytical learning, substituting theory with executive "war stories" may produce a generation of MBAs unprepared for tomorrow's challenges.



**EXEC ED** Former Intel CEO Andy Grove teaching at Stanford's B-school

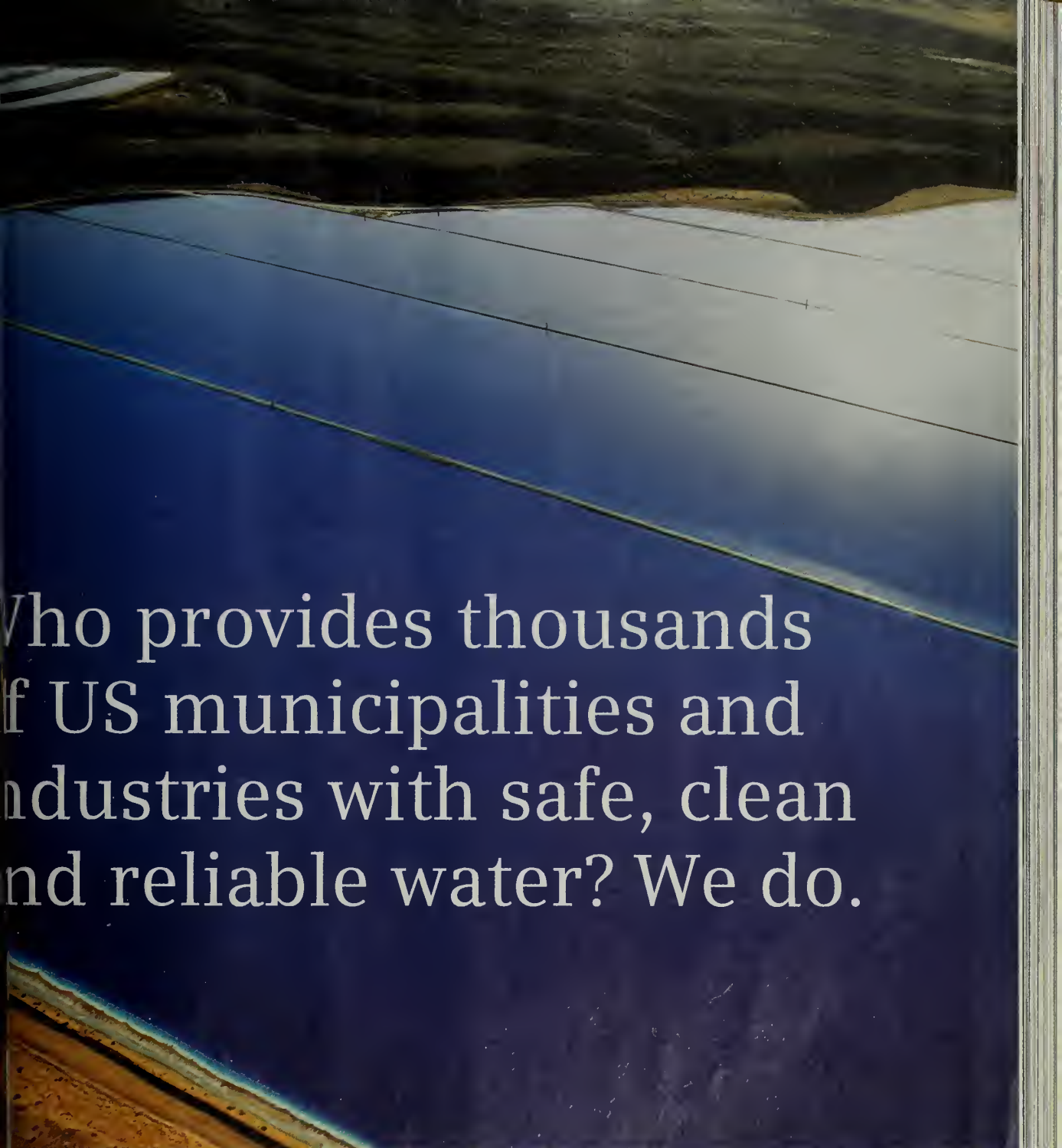
## THE CURE for a faculty shortage could shift the focus of curriculums from theory to practical knowhow

Fernandes acknowledges that this program, even if implemented in the long term, will not be enough. "The only real fix is graduating more PhDs," he says. "I hate to be a pessimist, but I just don't see that happening."

While Fernandes defends the program as a necessary measure, and insists it will make executives "as classroom-ready as any other graduate, including PhDs," that's far from certain. The program includes courses on teaching methods, learning styles, and classroom management, as well as an actual class session prepared by the executives. But critics say that hardly compensates for a lifetime behind a lecture-hall podium—or even the classroom experience that most doctoral candidates get in their six years in a PhD program. That's why the Cox School of Business at Southern Methodist University does not permit executives

"Theory and practice go together," says Edward A. Sirgy, dean of the University of Chicago Graduate School of Business. "People who understand theory are more likely to understand practice—today and tomorrow."

With baby boomer faculty on the cusp of retirement, the B-school brain drain may be at its worst in the next few years. To help fill the inevitable vacancies, AACSB will launch an executive-to-faculty program aimed at converting PhDs from business-related disciplines, such as economics and sociology, into new B-school faculty. The program is expected to take longer and be more costly than the one designed for executives. But it won't replace a single new PhD trained in the kind of management disciplines required for MBA programs. At best, it will be a partial solution to a seemingly intractable problem. ■



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**PRINGLE** The Tuck grad tracked down a job at a timber REIT

companies don't come to campus."

Location is another factor. Many schools aren't situated

where the jobs are. While recruiters flock to New York University's Stern School of Business, located a few miles from Wall Street, Northwestern's Kellogg School, north of Chicago, the number of recruiting companies drops considerably at schools that are outside business hubs. Chances are good that MBA job hunters will veer off-campus at such schools as Indiana University's Kelley School of Business in Bloomington, or Virginia University's Olin School of Business in St. Louis.

Schools are making more of an effort to assist independent searches by allowing students access to corporate databases in addition to providing alumni contacts. At Olin, independent search is so important that it's part of the curriculum. First-year students take a course focused on developing job search skills. "It is critical to our success," says Olin's Jim Beirne, director of career services. At Stanford,

where an estimated two-thirds of MBAs find jobs through independent searches, Chan advises students that it's impossible to know where a job might come from, so it's important to talk to as many people as possible. "Students need to feel comfortable just going out and going to companies," he says.

Independent job seekers are getting a welcome reception and not just at small companies. At JPMorgan Chase & Co., for instance, they account for nearly a third of the 75 MBAs each year for investment banking positions. To Barbara Farrell, one of the bank's recruiting managers, keeping an open mind about independent candidates makes all the sense in the world. "We can only get to a certain number of schools each season," says Farrell. "But we don't want to miss out on a

## Who Needs Recruiters?

More MBA grads are looking off-campus to find that perfect job. **BY GEOFF GLOECKLER**

**MBAs TYPICALLY GRAVITATE TO WALL STREET OR A Big Four accounting firm. Not Charles Pringle.** The recent grad from Dartmouth's Tuck School of Business was determined to find work in the forest products industry—even though doing so meant making the contacts himself. While many of his fellow grads set up on-campus interviews with investment banks and consulting firms, Pringle worked the phones, networking with Tuck alumni in the timber industry to unearth job leads. The handful of names supplied by career services quickly grew to 150. In February he hit pay dirt, landing a management position at Rayonier Inc., a Florida-based timber real estate investment trust.

Pringle's experience is increasingly common these days. Nearly a third of MBAs at top schools like Michigan, Cornell,

**HELP AVAILABLE** Schools are making more of an effort to assist independent job search

and Maryland now take on a job search independent of on-campus recruiting. Al Cotrone, director of career services at Michigan, credits a stronger economy. "Instead of taking a job anywhere they can find one, students are gaining more confidence," he says. "They are O.K. with graduating without a job and finding one on their own."

That includes veering off the beaten career path. "We get a lot of students interested in areas like private equity, hedge funds, and small entrepreneurial companies," says Andy Chan, director of career services at Stanford. "These kinds of

candidate just because they don't have the right school on their résumé." Amazon.com Inc. is also stepping up efforts to recruit independent job seekers. In the past the online retailer has recruited at only a handful of schools, but to get a large pool of candidates it's holding a regional recruiting event in Chicago later this year.

This is good news for the thousands of MBA grads like Pringle who are taking on an independent job search. Whether by choice or necessity, sometimes going your own way pays off. ■



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**Jennifer Elias and Julie Tucker, Founders, SmartsCo**

On a wintry night last year, SmartsCo, a publisher of party games, received a frantic call. A retailer needed stock overnight for a holiday event. So Jen and Julie packed their cars and hand-delivered it. "Likewise," says Jen, "when we sorely needed better cash flow, American Express cared enough to make sure we got it."



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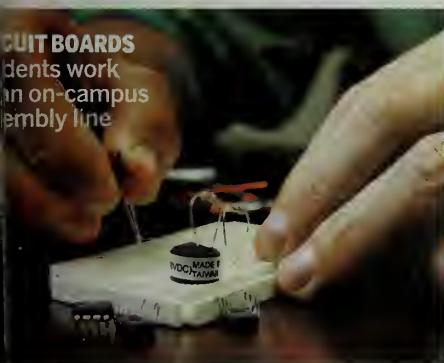
## Why Entrepreneurs for Entrepreneurs

Why those who run their own companies can teach  
Austin's Acton School of Business. **BY AMY BARRETT**

### SANDEFER DOESN'T EQUIVOCATE

He describes what's wrong with business schools. The 46-year-old, who founded the Acton School of Business in Austin, Tex., says they fail at preparing students to run their own companies. Sandefer, who runs an energy investment firm in Austin, says he has seen too many B-school grads unhappy with their lives five years after graduation. "We're the best and brightest to find their way," he explains. "Far more think consulting, investment banking, or real estate is more equitable than it really is."

**CIRCUIT BOARDS**  
Students work on an on-campus assembly line



### GAMING BET Acton offers what amounts to a money-back guarantee

Sandefer's Acton program is certainly a departure. For starters, all professors must be entrepreneurs. The requirement reflects Sandefer's view that, unless you are living the entrepreneurial life, you can't effectively teach it. How to be an entrepreneur. Compensation for professors is based in large part on student ratings. Each year the professor with the lowest ranking, out of the 11 now on the faculty, is not invited back to teach the following year (though they can return the next year). Half the length of traditional programs, Acton's one-year stint radicalizes the learning experience. While Sandefer, himself a Harvard

MBA, has built the program around his alma mater's case studies, students are never told what the best solution is, and professors aren't allowed to tell them.

Acton puts a premium on learning by doing. All students need to sell a real product as part of one class. And all must help run an assembly line set up on campus that manufactures circuit boards. "Few people know how to make the rubber meet the road," says Chris Shonk, 32, who graduated with Acton's first class in 2004 and went on to start his own boutique investment bank. "You learn how to execute."

Sandefer is so confident students will find the program rewarding that, starting this fall, he has created what amounts to a money-back guarantee. Tuition is \$17,500 per semester, but the first semester's check is returned at graduation, and the second semester is free. After graduation, students are still on the hook for the \$35,000 and are asked to contribute 10% of their salary until the tab is paid off. Then again, if a student is disappointed with the program, the debt is erased.

Without crippling loan payments, Sandefer contends, "you can follow your calling."

Of course, Acton has plenty of critics. Academics at other B-schools argue that a faculty made up solely of practicing entrepreneurs isn't well-balanced. And the relatively unknown school may not be a big asset for someone looking to land a job at a large company. "I know people applying to business schools who won't consider it because of the name," says Chris S. Munson, a 2005 Acton graduate who recently bought a restaurant chain with a partner. "But I'm convinced I learned more [there] than I would have learned anywhere else." ■

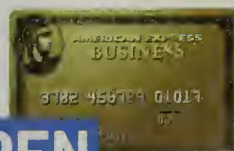
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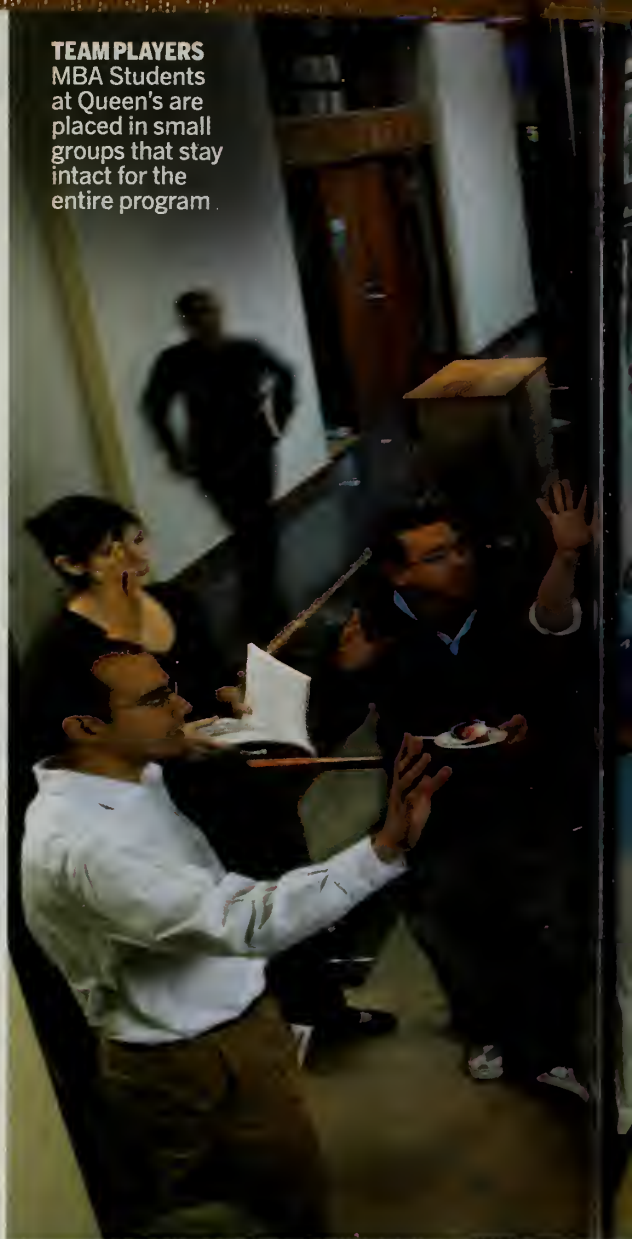
BY GEOFF GLOECKLER

**IN HER FIRST WEEK AS AN MBA STUDENT AT THE SPANISH** B-school ESADE, Elizabeth Caswell and her classmates were each asked to prepare a presentation on a company they felt would be a good place to work. Caswell selected KB Home, the \$9.4 billion Los Angeles homebuilder. When it was her turn, the Massachusetts native got up and shared her findings, complete with company financials and stock prices. When she finished, her classmates politely applauded her efforts.

In fact, they hated the presentation, likening it to a used-car commercial. She was brash and aggressive, they complained, extolling as she did the strengths of the company. Her confidence came off as arrogance. In short, the pitch was very American. "It was a major wake-up call," Caswell recalls. Over the next few months she learned to express her ideas in a more humble way, and soon she was no longer offending the sensibilities of her classmates.

What Caswell found at ESADE is what many potential MBAs are looking for, a program that offers a strong dose of management theory—and a global perspective. Because few U.S. MBA programs can match the diversity and international flavor of a school like ESADE, where 74% of students are from outside of Spain, more and more students are heading to

**TEAM PLAYERS**  
MBA Students at Queen's are placed in small groups that stay intact for the entire program.



schools in Europe and Canada. According to the Graduate Management Admissions Council, the number of American students attending MBA programs in countries like Spain, France, and England has risen from about 2,100 in 2003 to 3,550 in 2005.

This is good news for the top 10 schools in *BusinessWeek*'s 2006 ranking of the best non-U.S. MBA programs. While programs differ, each manages—through program design and classroom diversity—to expose students to a world of cultural differences. On average, 64% of the students from abroad, compared with 35% at the top 10 U.S. schools. With such breadth, students learn as much from their classmates as from their professors, not just about marketing and finance, but also about how management styles differ in various parts of the world. And this becomes more important as business becomes an increasingly global affair. "Students are beginning to understand that they have to learn to deal with specific problems they will face if they operate in Russia, China, or Brazil," says Jordi Canals, dean of the Barcelona-based IESE Business School.

For this year's ranking of non-U.S. MBA programs, *BusinessWeek* surveyed more than 2,000 students from



world's most competitive programs, as well as the recruiters who hire them, using the same methodology as the U.S. ranking. For the first time since the launch of the international ranking in 2000, three Canadian schools topped the list, led again by Queen's University in Kingston, Ont. The year marked by a battle for differentiation among top international schools, Queen's took top honors with an unconventional approach that treats students less like students and more like employees.

### WHAT IS IT LIKE A JOB?

WHAT DOES QUEEN'S DO IT? For starters, it divides students into groups of five or six "participants," with each group consisting of several different personality types and nationalities so that conflict is almost guaranteed. Unlike most schools, where new teams form for each class, Queen's students belong to a single team for the whole program, as they would on the job. Each team is assigned to a 20-foot "office" where each student has a cubicle and is expected to keep office-like hours. It's here that students spend a majority of their non-class time, discussing projects and working on assignments. And it's here where much of

the magic happens. Students learn how to work as part of a team—resolving differences and solving problems—in a way that can't be taught in the classroom. "Students are treated like professionals, and they're expected to treat it like a job," says Alan Ridgeway, a 2006 Queen's grad.

This experiment in reality learning has students and recruiters singing the school's praises. But administrators aren't easing up. In late September, Dean David Saunders announced plans for a curriculum redesign that will allow students to customize their course loads based on their experience and career goals. For Saunders, the decision to make the change was simply a question of listening to the market. "We talked to employers and alumni and built off of their feedback," Saunders says.

Indeed, if there's one lesson that international B-school administrators have learned this year, it's that the needs of recruiters matter just as much as those of prospective students. To deliver the kinds of grads who can hit the ground running, the University of Western Ontario's Richard Ivey School of Business last year cut the length of what had been a two-year program in half and revamped the curriculum. The school now requires students to examine case studies from



# TheBestB-Schools

numerous viewpoints, in essence grouping together various disciplines—finance, marketing, operations, and so on—that would ordinarily be chopped up into individual courses. “We’re thinking about it as learning from an issues perspective as opposed to a functions perspective,” says Ivey Dean Carol Stephenson. The changes seem to be working: Western Ontario rocketed up four spots, to No. 2, and was the top choice of recruiters, who say Ivey grads are quickly able to adapt to the workplace with little additional training.

## SOLUTIONS TO THE HIRING PUZZLE

AS IMPRESSIVE AS THAT SOUNDS, Ivey’s improvement in the ranking was modest compared with that of the University of Toronto’s Joseph L. Rotman School of Management, which leapt six spots, to No. 3, the biggest jump in the ranking. In 2004, Rotman grads said it was hard to find jobs even at the Canadian companies making an annual pilgrimage to campus. In response, the school designed new courses on everything from presentation skills to networking and brought corporate leaders and alumni into the classroom. Sean Bartman, a senior manager of recruiting at Canadian Imperial Bank of Commerce, is one of a handful of recruiters who visit Rotman to hold mock interviews and training sessions. According to Bartman, who helped implement the sessions, these are important pieces of the hiring puzzle. “You can’t just go into an interview cold and expect to do well,” he says. Judging from the hiring numbers at Rotman, the work is paying off. For the class of 2006, 94% had a job offer within three months of graduating, the school’s best job placement performance in years. The only real complaint from students at Rotman is that they would like to see a few more companies from outside of Canada visiting campus.

With Canadian schools dominating the upper end of



**GLOBAL PERSPECTIVE** At Spain’s ESADE, Caswell’s classmates gave her “a wake-up call”

the list, several highly ranked European schools found themselves slipping to the middle of the pack this year. IMD fell to No. 4, from No. 2, despite receiving the best possible ranking in the student survey. The Lausanne (Switzerland) B-school, where students average seven years of work experience—far more than any of the other schools in our ranking—is the destination of choice for those in search of highly experienced classmates, and who might otherwise choose an executive MBA program. That was the choice that confronted Laurent Collier before he chose “I was already a manager with a good salary,” Collier. “I wanted to be working with people that had the [level of] experience as me.” What Collier found in the 11-month IMD MBA was an intense, boot-camp-like experience.

## International Report Card

### The Top MBA Programs from Canada and Europe

| 2006 RANK | SCHOOL                                | 2004 RANK | CORP POLL | GRAD. POLL | INT. CAP. 3 | MEDIAN PAY 1 (Thousands) |          | DESCRIPTIONS                                                                                                               | GLOBAL SCOPE |
|-----------|---------------------------------------|-----------|-----------|------------|-------------|--------------------------|----------|----------------------------------------------------------------------------------------------------------------------------|--------------|
|           |                                       |           |           |            |             | PRE-MBA                  | POST-MBA |                                                                                                                            |              |
| 1         | <b>Queen’s</b> Kingston, Ont., Canada | 1         | 3         | 2          | 7           | \$48                     | \$73     | Workload is intense, but personal attention from professors is second to none. Program attracts many scientists, techies.  | B            |
| 2         | <b>Western Ontario</b> London, Canada | 6         | 1         | 6          | 4           | 45                       | 75       | Holistic approach with heavy case-study emphasis prepares grads for real-world challenges; extracurriculars add to appeal. | B            |
| 3         | <b>Toronto</b> Toronto                | 9         | 2         | 10         | 2           | 45                       | 75       | School gets top marks from grads going into finance; might not be the best place for career switchers.                     | A            |
| 4         | <b>IMD</b> Lausanne, Switzerland      | 2         | 8         | 1          | 10          | 75                       | 120      | Grads say the brief, 11-month program is great for developing culture but too short for those weak in business skills.     | B            |
| 5         | <b>London Business School</b> London  | 5         | 11        | 3          | 1           | 60                       | 110      | London locale paired with strong alumni network creates ideal climate for job seekers; top American-style MBA in Europe.   | A            |
| 6         | <b>INSEAD</b> Fontainebleau, France   | 3         | 12        | 4          | 3           | 66                       | 101      | Students love the diverse class makeup but warn that the intense program is not for the faint of heart.                    | A+           |
| 7         | <b>ESADE</b> Barcelona                | 4         | 7         | 7          | 14          | 40                       | 70       | Quality classmates and Spanish lessons promote cultural fluency; weak career services leave a bitter aftertaste.           | A+           |
| 8         | <b>IESE</b> Barcelona                 | 7         | 13        | 5          | 9           | 50                       | 95       | Students are immersed in Barcelona culture and develop invaluable networks with tight student body and faculty.            | A+           |
| 9         | <b>York</b> Toronto                   | NA        | 5         | 12         | 8           | 40                       | 65       | Students say career services could be improved, though they like the balance between theory and real-world experience.     | A            |
| 10        | <b>HEC</b> Montreal                   | 10        | 10        | 11         | 13          | 49                       | 69       | Called a great value for the money by students, some complain about classmates with inadequate work experience.            | C            |

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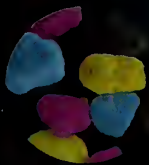
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# TheBestB-Schools

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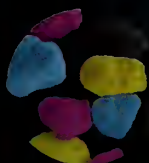
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For many European schools, the most troubling problem this year was a perennial one: attracting international students. With so many foreign students looking to return home to work after earning their MBA, schools that to attract recruiters from those countries are at a disadvantage. This is, no doubt, one reason why No. 6-ranked INSEAD hired J. Frank Brown, a retired executive of PricewaterhouseCoopers, as its new dean—to attract more international companies to the school's Fontaine-

bleau (France) and Singapore campuses.

It doesn't help that many smaller, regional recruiters aren't able to pay the high salaries that are a top priority for most students. Patricia Ferrando, a recruiter at Barcelona-based EuroPraxis Consulting, which hires at INSEAD, ESADE, and IESE, says it's becoming more difficult to get MBAs from those schools in the door. "It's hard to compete for top talent," she says.

European and other international schools sometimes complain that poor name recognition puts them at a disadvantage when competing against Harvard, Wharton, and other top U.S. schools. But if they continue to succeed in producing graduates who can thrive in the global marketplace, that may change. ■



**THUNDERBIRD LG**  
students graduate  
from a custom  
MBA program

expats to  
China," says  
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An in-house

MBA program is one way companies can build up their supply of globally qualified managers skilled in Western-style management practices. Judy Frels, Maryland's director of custom programs, says the MBA degree also motivates employees better than a nondegree training program would.

There are other, real-world benefits. Open enrollment courses usually exclude sensitive company information. Not so custom MBAs. As students participate in class discussions and projects, they absorb business theory while solving company problems. In Thunderbird's LG program, for example, students learn supply-chain management by examining how LG can best distribute \$200,000 worth of spare parts to the company's far-flung operations.

Custom programs help B-schools expand their global knowledge, too. Professors get inside information about specific industries and countries that they can bring back to their classrooms in the U.S. And several B-schools have used their custom programs to gain footholds abroad. Arizona State's custom program for Motorola led to the development of the school's successful Shanghai MBA, and the University of Michigan's program for Cathay Pacific Airways has morphed into the East Asia Management Development Center.

Since word of the LG program has spread, Thunderbird has received inquiries from four other companies in East Asia interested in exploring similar programs. With the explosive growth in Asia showing no signs of slowing, custom MBA programs look to be a growth industry.

—By Kerry Miller

## The B-School of Your Company's Dreams

Customization is one of the hottest business trends around. Now business schools are getting into the act, too. Faced with increased competition, schools are tailoring entire degree-training MBA programs to the needs of specific companies.

Nowhere is this happening more than in fast-growing Asia, where more businesses are willing to make the investment. This past June, Thunderbird, The Garvin School of International Management, graduated LG Electronics executives from its custom MBA program. By 2010, the school

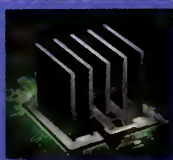
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Why choose a custom MBA over a one-size-fits-all executive MBA or a customized nondegree executive-education course? B-schools say a made-to-order graduate business degree meets the needs of fast-growing multinationals interested in developing and retaining local talent. "You can only send so many



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**ON OCT. 22, SOME 5,000 PHYSICIANS** will convene in Washington for five days of discussions about high-tech heart treatments. Representatives of more than 160 medical-device companies also will be there to promote their valves, catheters, and stents. This annual confluence of medicine and commerce is carefully choreographed, but still, things don't always go as planned.

In September, 2004, with thousands of doctors at the conference watching live by satellite on giant screens, a cardiologist in Milan inserted an experimental heart valve into a gravely ill patient. Suddenly the patient's heart began to fail. For 45 minutes the stunned audience watched a series of desperate life-saving attempts, until finally the satellite transmission was cut. The patient died later that day. "It was harrowing," says Dr. Martin B. Leon, the New York heart specialist who started the influential conference 18 years ago. "That was a very difficult thing for us."

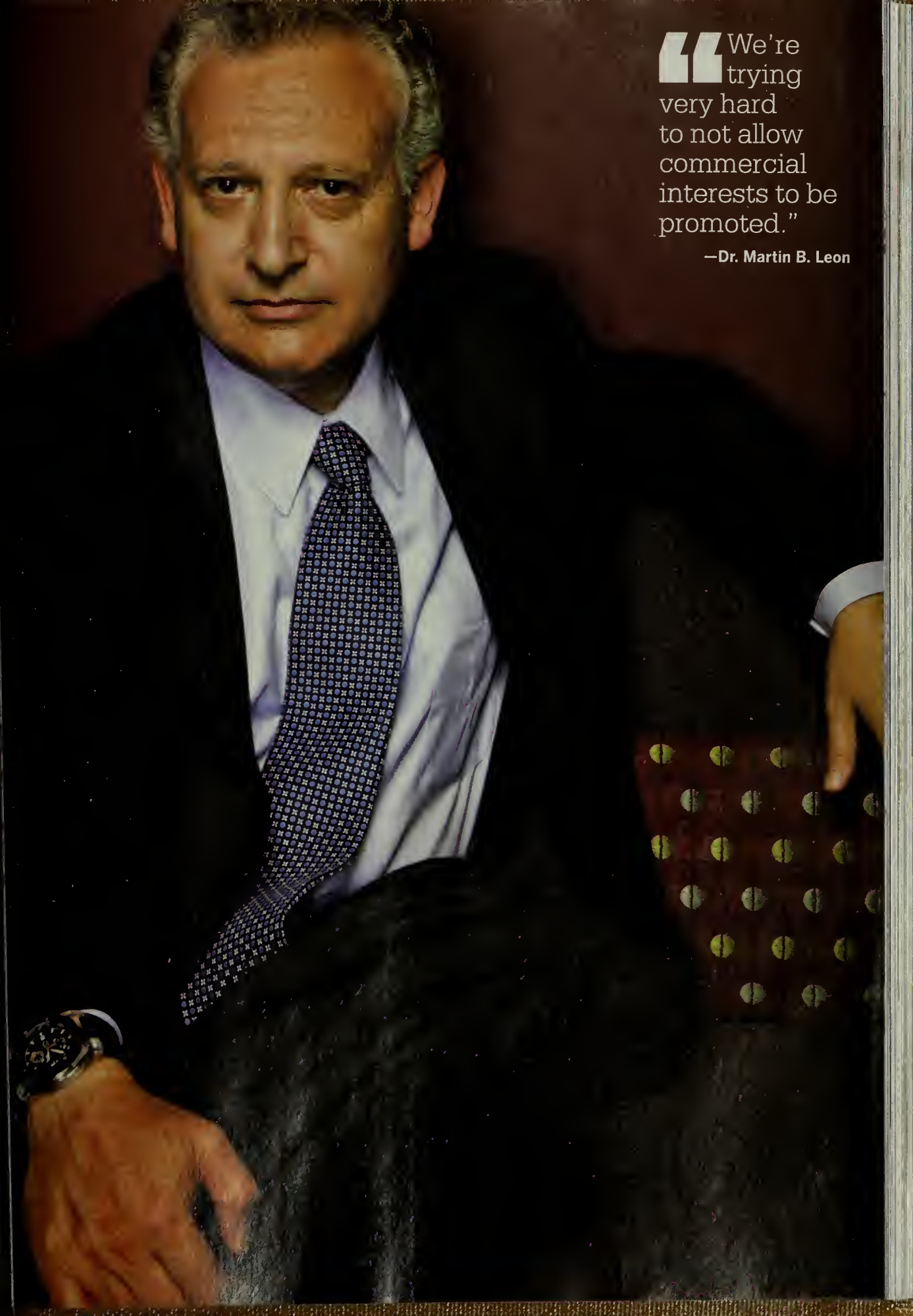
Leon's anguish over the incident remains palpable, but he also had a financial interest in seeing the valve work. He co-founded the small company that invented the device. That company was sold to Edwards Lifesciences just a few months before the device was used in the televised procedure. The deal netted Leon \$6 million in cash, plus the chance to earn an additional \$1.5 million if the product achieved certain milestones, one of which related to the number of patients successfully treated.

Did Leon's financial stake in the experimental device play a role in its being promoted at an important conference where he is the most prominent figure? "Absolutely not," Leon says. The question, he adds, "borders on being offensive." Nevertheless, he now wonders whether the

## Medicine In Conflict

There is more concern  
than ever that doctors are  
blurring the lines between  
objective science  
and financial gain

BY ARLENE WEINTRAUB  
AND AMY BARRETT

A portrait of Dr. Martin B. Leon, a middle-aged man with graying hair, wearing a dark suit, light blue shirt, and a patterned tie. He is looking directly at the camera with a serious expression. His left hand is visible at the bottom left, wearing a watch. The background is dark and out of focus.

“We’re  
trying  
very hard  
to not allow  
commercial  
interests to be  
promoted.”

—Dr. Martin B. Leon



technology was refined enough to be ready for prime time.

As Leon prepares for this year's conference, he does so amid renewed anxiety over the mixing of medical and corporate interests. Spurred by widespread concern that industry money has too much influence on patient care, the nation's leading medical institutions are reining in doctors. In May, the Cleveland Clinic tightened its conflict-of-interest procedures after ties between device companies and prominent doctors there came to light. Several top academic medical centers have ordered physicians not to accept even trivial company giveaways. "We don't think about whose pen we're holding or who bought us that last pizza, but it creates influence," says Dr. P.J. Brennan, chief medical officer of the University of Pennsylvania Health System.

Leon's career illustrates the potential conflicts that have become commonplace and are prompting the new rules. The doctor, who traces his choice of profession to the day his grandmother died in his arms after a heart attack, is chairman of the Cardiovascular Research Foundation in New York. The foundation uses donations and fees from medical device companies to stage Leon's annual conference, called Transcatheter Cardiovascular Therapeutics (TCT). A professor of medicine at Columbia University, he has helped start a handful of cardiac device companies through a corporate "incubator" he co-founded. He also has served as a paid scientific adviser for several other startups. Over the years, companies to which he has had close ties have been featured prominently at TCT, creating at minimum a perception that the companies' products are favored for reasons other than medical merit.

"Things that Marty is part of get exaggerated attention" at the conference, gripes the CEO of one device startup. The CEO declined to be identified out of fear he would offend Leon and imperil his company's treatment at TCT.

Mostly undisclosed until six years ago, the tangle of physicians' financial interests at TCT is now acknowledged in a booklet distributed to participants. In 2005 no fewer than 345, or 44%, of the more than 750 doctors and researchers who made presentations at TCT had received compensation from companies, some of whose products they evaluated at the conference.

Beyond the danger that conflicts may distort individual

clinical decisions, some TCT observers worry that the event engenders a general excess of enthusiasm for complicated device-based procedures. From 1986 to 2003 the number of nonsurgical cardiac procedures, such as propping open arteries with wire-mesh stents, rose twelvefold, according to the American Heart Association. Such procedures "are uncomfortable, relatively expensive, and may be taking the focus away from less invasive, equally effective treatments, such as taking medicine," says Dr. David D. Waters, chief of cardiology at San Francisco General Hospital.

TCT undeniably excites excitement about device technology. When new products perform well in the live cases—time procedures beat in from hospitals all over the world and viewed at the conference—a crowd of interested doctors and investors typically gathers around the booths of the relevant manufacturers. "Marty turns the medical meeting into an auto show," says Dr. Steven F. Seides, associate director for cardiology at the Washington Hospital Center.

Leon, 55, says his conference keeps doctors abreast of new techniques, and notes he has toned down in recent years. Product names, for example, are no longer displayed prominently on-screen during cases. His main answer to questions about conflicts is to disclose them.

echoes that of most other branches of medicine: more disclosure. "If you're a faculty person at TCT," he says, "you can do anything unless you disclose your conflicts." The Association and other medical groups have recently issued detailed new disclosure guidelines, and medical journals have followed suit (page 80).

But as the volume of disclosure rises, some fear the process will become a mere formality, attracting only cursory attention. Dr. Ezekiel J. Emanuel, chair of the department of clinical bioethics at the National Institutes of Health, observes everyone is disclosing, it's as if no one is disclosing."

Born in Brooklyn, N.Y., into a close-knit family, Leon was only 17 when his grandmother died. He endured a severe loss as he was finishing medical training at Yale University in 1982: His mother had a fatal heart attack after bypass surgery. Convinced that traditional surgery isn't always the best for heart patients, he chose to enter a new subspecialty: interventional cardiology. Interventional cardiologists use catheters to fix plaque-laden arteries and fix irregular heartbeats without invasive surgery. Leon became a researcher in the young



“[Martin Leon] helped make Abiomed's product more user-friendly.”

—Michael Minogue  
CEO, Abiomed



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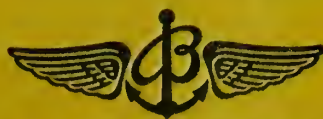


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joining the National Institutes of Health in 1983.

Back then it was still unusual for practicing physicians or academic researchers to double as entrepreneurs. Two developments helped erode the wall. The Bayh-Dole Act, enacted in 1980, sped up the commercialization of discoveries at university labs by allowing them to hold patents. Named for its sponsors, Senators Birch Bayh (D-Ind.) and Robert Dole (R-Kan.), the law turned academic research into a revenue center, as universities licensed findings to companies and shared royalties with the M.D. and PhD staffers responsible for the discoveries. Doctors learned they could go into business while continuing to practice medicine.

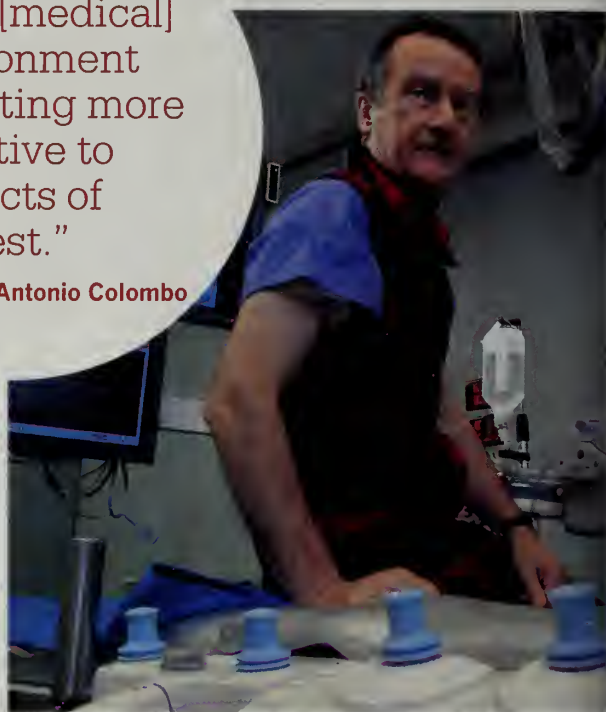
Meanwhile, health maintenance organizations began to clamp down on physician pay. That prompted some doctors to turn to device and drug companies eager to hire them to consult or give speeches. Few rules existed to restrict such activities. The growing partnership between doctors and industry created an expanding constituency for TCT, which Leon and an NIH colleague had decided to start over a six-pack of beer in 1988. Their goal, Leon says, "was to see if we could develop better techniques that would be more durable, safer, more predictable than what we had."

Leon's first consulting arrangement with a company grew out of the inaugural TCT in Washington. Marvin Woodall, who headed Johnson & Johnson's new cardiac-devices division, asked Leon to serve as the unit's paid ex-officio medical director. As an adviser, Leon was prescient and blunt, Woodall recalls. The cardiologist once dissuaded him from paying \$93 million for a company trying to use lasers to open clogged arteries. "Laser angioplasty never did work that well," says Woodall, who is now retired from J&J and serves as CEO of Leon's research foundation.

By 1990, Leon, then 39, with a wife and two children, felt confined intellectually and financially by his government job. "I was making \$52,000 a year, and it was important for me to be able to do other things," he says. He left the NIH, joined the

**“The [medical] environment is getting more sensitive to conflicts of interest.”**

—Dr. Antonio Colombo



medical faculty of Georgetown University, and became a cardiologist at the Washington Hospital Center, where he conducted clinical trials for startup device companies.

Leon and TCT have provided a launching pad for many small companies. "It is the premier forum for the introduction of new technology," says Howard Leonhardt, CEO of BioCryst Inc., which is developing several cardiac devices. Leon agreed to serve on the company's scientific advisory board in 2000. "He introduces us to the right people," Leonhardt says. " "

## Prescriptions for the Many Strains of Conflict

Worried that doctors' financial interests in drug and device companies could distort their judgment, the medical profession is responding on a number of fronts

### CONFLICT

Some academic medical centers have loose policies on how physicians disclose ties to companies and how those conflicts are relayed to clinical-trial patients.

When deciding whether to approve new products, the FDA consults advisory committees, which can include physicians who are paid consultants to medical companies.

Pharmaceutical sales representatives often feed doctors and their staffs pizza or sandwiches while pitching new products to the physicians.

Some physicians who submit data to medical journals aren't entirely forthcoming about the compensation they receive from the companies whose products they're testing.

Drug and device companies sponsor continuing-education courses for physicians, creating an opportunity for the promotion of their products.

### RESPONSE

Several institutions, including the Cleveland Clinic, are requiring more stringent disclosure and they are firing physicians who don't comply.

In July, the agency announced that it will review how it manages conflicts of interest on its advisory panels, with the goal of improving transparency and disclosure.

Backed by studies showing that even the smallest gifts might sway doctors' prescribing habits, many medical practices are banning free lunches from industry.

Prominent journals are demanding more detail from authors about potential conflicts, and are even rejecting papers from some who are closely tied to companies.

The agency that governs continuing medical education expanded its conflict-of-interest guidelines last year, and will begin monitoring educators' compliance in November.



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a prominent leader at the cutting edge." Bioheart is testing a cell-based therapy for repairing damaged hearts using a catheter designed with Leon's input.

At TCT, Leon makes speeches, presents data, and comments on some live cases. He is "a mixture of teacher and showman," says Dr. Patrick W. Serruys, chief of interventional cardiology at the Thoraxcenter-Erasmus University in Rotterdam and a longtime TCT participant. Once, after losing his voice, Leon sought out President Bill Clinton's throat doctors, who suggested swallowing a large dose of steroids. He did, and went on speaking. At the 1997 confer-

ence, Italian cardiologist Antonio Colombo (the same doctor whose patient died during the 2004 event) transmitted a procedure during which he used a tiny motorized device to clear plaque from a professional singer's artery. On camera, the patient began singing *O Sole Mio* to the accompaniment of a guitarist sitting by his side.

Through the 1990s, Leon and other interventional cardiologists had links with companies they didn't routinely acknowledge at the conference. "There were conflicts for all of us," says Richard Schatz, a cardiologist at Scripps Clinic in San Diego and the co-inventor of the Palmaz-Schatz stent, the J&J product

## How the Journals Are Cracking Down

**D**r. Catherine D. DeAngelis feels queasy when she thinks about the paper her medical journal refused to publish last year. It was just after her publication, the *Journal of the American Medical Assn.* (JAMA) adopted a policy requiring that any study funded by a pharmaceutical or medical-device maker undergo a second review by a statistician with no financial ties to that company. One study's authors promptly pulled a manuscript from JAMA and submitted it to another journal, which published it without independent review, JAMA reports. "I'm watching that product," says Editor-in-Chief DeAngelis, who declines to name either the company or the rival journal. "If it turns out to be the next Vioxx, I'm going public."

With concerns about conflicts of interest on the rise, many medical journals are cracking down. Some are demanding more detailed disclosures from authors about how they're compensated by companies, and many are more skeptically scrutinizing papers that academic and company scientists produce together.

A series of embarrassments prompted these actions. Last year editors of the *New England Journal of Medicine* (NEJM) alleged that information about the heart attack risk caused by the painkiller Vioxx was inappropriately excluded from a study the journal published in 2000. In written statements, Vioxx' maker, Merck & Co., has denied any impropriety. JAMA, meanwhile, has uncovered several examples of authors failing to disclose financial conflicts



concerning other drugs. In the June 7 issue, the journal printed four paragraphs of corrected disclosures related to a single study. "As I began to see more slippages and blatant lapses, I had to make it clear we won't accept this," DeAngelis says.

When does an author's relationship with industry raise questions about objectivity? Dr. Jeffrey M. Drazen, editor-in-chief of NEJM, says he's especially wary of authors who have stock options in companies that make the products they're studying. Even though the options may be worthless today, Drazen says, "we've disqualified papers on the basis of appearance. If anything they write can enrich them in the future, we 'X' them."

Proving just how difficult it has become

to untangle business and medicine, however, NEJM loosened its conflict-of-interest policy in 2002. Previously it had refused to publish editorials or reviews by authors with any financial interest in companies they wrote about. Now it disqualifies only authors with

"significant" ties. Drazen says it became impossible to enforce the old policy, since most physicians have received something from a company, be it as trivial as a mouse pad or pen. The change incensed former NEJM Editor-in-Chief Dr. Jerome P. Kassirer, author of the 2005 book *On the Take*, an inside look at the deepening financial ties between physicians and drug companies. "Too difficult to find people without financial conflicts," Kassirer says. "You just have to look harder."

Other medical journals appear to be moving toward zero tolerance for conflicts. In August the editor of *Neuropsychopharmacology*, Dr. Charles B. Nemeroff, stepped down after the journal published a paper

**“As I began to see more... lapses, I had to make it clear we won't accept this.”**

**—Dr. Catherine DeAngelis**

he co-wrote about a device without revealing that he had financial ties to the manufacturer. Nemeroff and his co-authors submitted disclosure forms with the manuscript, but a clerical error caused the information to be left off the published paper, Nemeroff says in an e-mail to *BusinessWeek*. "A correction regarding that information has been published," Nemeroff writes. "However, the controversy has become distracting to the mission of the journal."

**—Arlene Weintraub**

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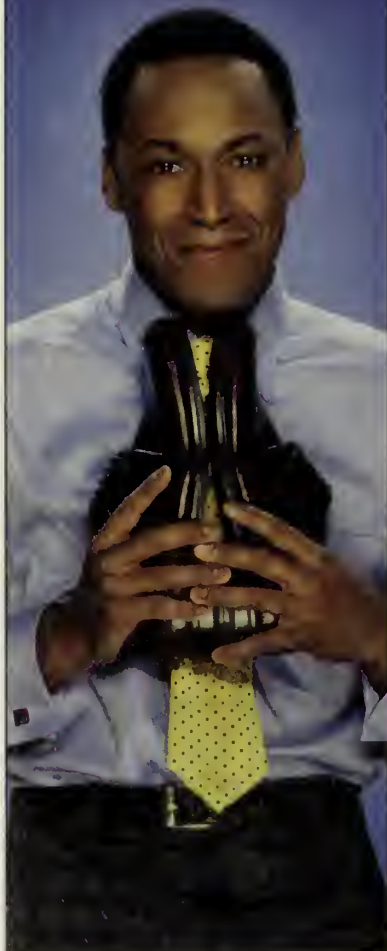
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## SpecialReport

launched the stent industry. "Those were naive days. Those days are over."

To comply with guidelines issued by health-care associations, Leon has become more of a stickler about disclosure by all TCT faculty members. But a look at some of Leon's own acknowledgments reveals that they sometimes don't tell the whole story.

In 1999 he co-founded a company called Percutaneous Valve Technologies Ltd. (PVT), which developed a cardiac valve that could be implanted by a catheter snaked through an artery, rather than open-heart surgery. When Edwards, based in Irvine, Calif., bought PVT for \$125 million in early 2004, Leon collected his roughly \$6 million. In addition, he and other PVT shareholders were promised a total of three \$10 million payments upon the achievement of three milestones: the successful treatment of 50 patients, regulatory approval in Europe, and limited approval in the U.S.

At TCT later in 2004, Leon disclosed the relationship simply as "PVT-Edwards," one entry in a list of 26 companies from which he received equity, consulting fees, or research grants. He didn't spell out the potential milestone payments in the TCT materials. Doctors who watched the live procedure that ended with the death of the patient in Milan might not have known that the conference's leading figure had an intricate and continuing relationship with the manufacturer of the device being implanted.

Edwards CEO Michael Mussallem's presentation at the event was appropriate, stressing that Leon disclosed relationship with the company. The demonstration "gave the technology a lot of visibility, no doubt about it," he says, but he argues that this will have little effect on whether the milestones are ultimately achieved. Leon says the disclosure was formed with TCT policies and those of medical associations.

Since the mid-1990s, he says, local committees of doctors have made decisions about what material will be presented at the conference. "We're trying very hard to not allow commercial interests to be promoted by TCT," he says. But he concedes he retains veto power over who takes the stage and what appears on the video screens. Others in the industry say the perception lingers that Leon influences many aspects of the conference. Asked about this, he says: "I'm extremely sensitive to potential conflicts of interest, and I tend to be overprotective and careful about making sure there is no undue bias." For the first time this year, he and two doctors who are not affiliated with Leon's foundation will review all presentations planned for the conference, along with the disclosures provided by the selection-committee members, to ensure that industry money has no sway.

To comply with Columbia's policies, Leon has recently simplified his web-based financial relationships. Earlier this

## 'Disclosure Is A Lousy Solution'

**E**ven as disclosure has emerged as the all-purpose solution for financial conflicts of interest in medicine, recent research suggests that the practice may exacerbate the problem. That's the conclusion of a paper published last year in *The Journal of Legal Studies* called "The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest."

Using volunteers, researchers at Carnegie Mellon University created a scenario in which some experts in a position to give advice disclosed conflicts of interest, while others concealed them. The task at issue was highly abstract: estimating the number of coins in large bottles. The advisers who disclosed their conflicts exaggerated the advice they gave, possibly because they felt the disclosures gave them moral license to lie, the researchers concluded. Those who received the advice didn't seem to place much importance on the disclosures.

"Disclosure is a lousy solution," says Don A. Moore, an associate professor of organizational behavior at Carnegie Mellon's Tepper School of Business. "Mostly it's just foisting information on people who are insufficiently prepared to make use of it."

—Arlene Weintraub



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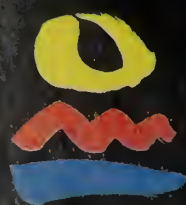
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ys, he donated his rights to the Ed-  
s milestone payments to a school in  
hattan, which he declines to identify.  
is so he can participate in current  
al trials for the PVT valve, which  
een refined since the 2004 live case.  
in 2005 he gave up the \$257,679  
al salary he had been drawing from  
oundation. But he makes no apolo-  
for accepting payments from manu-  
rers. "If you expend a significant  
int of time and effort" helping a  
pany develop a new device, he says,  
e will be financial remuneration."

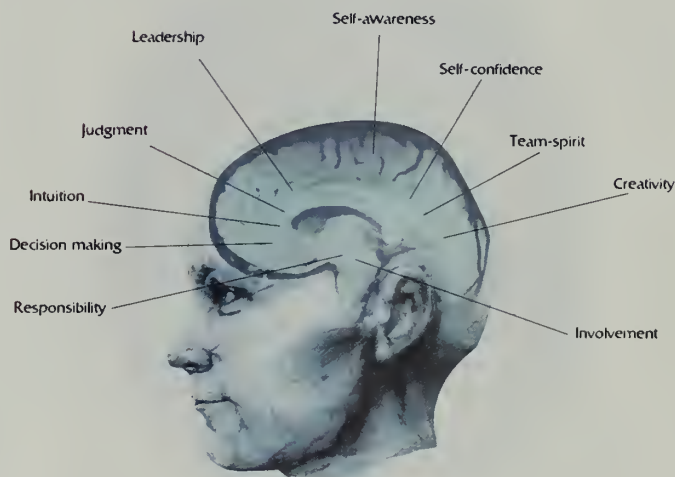
other complicated Leon relation-  
concerns Abiomed, a company in  
ers, Mass. In 2005, Leon's incu-  
; Accelerated Technologies Inc.,  
a small company called Impella  
biomed for \$42.2 million in stock.  
lla had invented a tiny pump that  
the heart do its job and can be  
uted in minutes. Three versions  
are on sale in Europe, and the  
any is conducting clinical trials in  
.S. Leon received stock then worth  
y \$1 million, plus the opportunity  
eive a small share of up to \$16.75  
n in milestone payments, based in  
on Abiomed's regulatory approvals  
nits sold. Six months later, Impella  
eatured in two live cases at TCT. At  
me conference, Abiomed co-spon-  
an evening event featuring doctors  
g about heart pumps. Leon, who  
he keynote speaker, noted briefly  
disclosure booklet and on a slide  
preceded the presentation that he  
"major shareholder" of Impella-  
ued. He retains the opportunity  
ect milestone payments from the  
ny.

omed CEO Michael Minogue says  
e involvement isn't problematic.  
oesn't own that high a percent-  
the company, and he's not in-  
in the trials," Minogue says.  
he has brought to the company  
he helped make the product more  
riendly."

year's TCT promises the event's  
er panel on conflicts of interest.  
nt authorities on medical ethics  
cheduled to participate. The confer-  
overall offers 704 hours of presenta-  
the time allotted for the conflicts  
s 30 minutes. ■

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DAVID HENRY

IT MIGHT BE PURE ACCIDENT that one of the most important financial innovations of the past 20 years carries the clunky name "collateralized loan obligation."

Or it might be that the wizards behind the instrument could work magic best behind a curtain of baffling adjectives and nouns. So far the instruments have escaped major scrutiny, while market watchers have spent the past few years wringing their hands. Hedge funds, CLOs have become an increasingly integral part of the financial firm—and just as worrisome.

They're novel creations. CLO managers essentially buy a bunch of loans arranged by banks, package them together into a pool, and then carve out different tranches to sell to investors, taking a fee for their troubles. While the loans they buy are mostly "junk"—meaning they have low credit ratings—the securities carved from the pool are mostly "investment-grade," carrying high ratings. That, that attracts people seeking the safest investments.

Can you really squeeze that much out of that much risk? The idea is that risks are so dispersed that most investments end up doing well. Yet there's something akin to a perpetual-motion machine at work here. How long can it go on?

Think of CLOs as the next step of financial innovation that started with junk bonds and mortgage-backed securities, which revolutionized the mergers-and-acquisitions and mortgage businesses, respectively, in the 1980s. Now CLOs are the same for the \$500 billion commercial lending market. They're making it cheaper for companies, lowering the risk for lenders, and, so far, providing investors with enviable returns. CLOs are powering two other arenas, too: the leveraged-equity business, which counts on junk for financing, and the \$14 trillion commercial market, which has been propped up recently by furious buyout activity. That CLOs, leveraged buyouts like the \$27 billion deal for hospital operator HCA Inc. wouldn't be happening on such a grand scale.

Wall Street is pushing CLOs with full force. Year to date, CLO managers have raised \$90 billion, double last year's total at this point, which was double the amount before that. "Just about every man and his dog is trying to do a CLO at the moment," says Michael Peterson, editor of *Creditflux*, an industry news service.

In fact, unbeknownst to many, CLOs are pumping up the entire U.S. econ-

# Danger—Explosive Loans

Collateralized loan obligations offer loads of cheap money. But payback time may be coming





my. By lowering borrowing costs and attracting foreign capital, they're helping to keep a lid on interest rates. For years economists have professed amazement that long-term rates have stayed low even as short-term rates have risen. Innovations like CLOs are a big reason why. They've kept the gears of the world's biggest economy so well-oiled that foreign investors can't help but be attracted to it.

But while financial innovations fuel booms, they also tend to worsen busts. Wall Street's lack of willpower is legendary. The pattern goes like this: Come up with a brilliant idea, nurture it until it catches on, then flog it until it breaks. So far, the market has performed smoothly. But CLOs are financing dicier endeavors all the time. They've encouraged companies to take on more floating-rate debt, which could cause problems like those now being felt by homeowners who took out adjustable-rate mortgages a few years back. CLOs also have encouraged companies to put up more of their assets as collateral for lenders, which during hard times could hinder their financial flexibility. And CLOs' successes so far have lulled investors into a false sense of security: Sometime in the next few years, a blowup is likely—one that could sink an already foundering economy. "The losses are going to be more severe in the next downturn," says James Grant, editor of *Grant's Interest Rate Observer*.

CLO managers are using financial engineering techniques dating back to the emergence of junk bonds. For borrowers, loans are preferable to bonds, which fueled the last buyout boom, because loans can be repaid at will. CLO deals first appeared in the early 1990s and picked up speed as the loan market grew to include commercial bank loans. By 2002 the structures were being designed well enough to rekindle corporate lending after the telecom bust.

Their ingeniousness allows them to haul in more money from investors than Wall Street could raise with an army of its finest salesmen. Essentially, the devices vacuum

## Garbage In, Gold Out

**COLLATERALIZED LOAN OBLIGATIONS** really do turn junk-rated loans into AAA-rated securities. One step is making sure the loans are from diversified borrowers. But the real transformation comes by ranking investors so that those at the bottom absorb losses before the rest lose a penny. Below is the pecking order a typical CLO follows as it collects and distributes money. In this simplified example, AAA investors won't lose unless the CLO loses 25% on its loans. AA investors won't lose until losses top 19%; A investors not until losses top 14%.

### THE ASSETS THAT GO IN

- » Corporate loans from about 85 borrowers.
- » Loans are rated below investment-grade, usually BB down to CCC, with an average of B.
- » Borrowers pay interest at the London interbank offered rate (LIBOR) plus 2.3 percentage points.

### THE SECURITIES THAT COME OUT

| SECURITY                    | SHELTERED FROM LOSSES BY | SHARE OF ASSETS | YIELD             |
|-----------------------------|--------------------------|-----------------|-------------------|
| AAA-rated notes             | all classes below        | 75%             | LIBOR + 0.25      |
| AA-rated notes              | next classes below       | 6               | LIBOR + 0.43      |
| A-rated notes               | next classes below       | 5               | LIBOR + 0.73      |
| BBB-rated notes             | next classes below       | 4               | LIBOR + 1.45      |
| BB-rated, junk-grade, notes | equity class below       | 3               | LIBOR + 3.60      |
| Equity, unrated             | nothing                  | 7               | Maybe 13% or 14%* |

\* Based on weighted average payments to note holders of LIBOR + 0.43 and on uncertain assumptions of 2% constant annual default rate and 70% recovery rate on defaulted loans.

up junk-rated leveraged loans and, voilà, turn out investment-grade notes. Think of a CLO as an upside down pyramid in which a few people at the bottom support many at the top. A CLO's top tiers of securities receive AAA and AA credit ratings. These rate so highly because they're insulated by the lowest-ranking securities, which are the first to suffer any losses. Recently CLOs have been collecting yields from their loan pools about 1.9 percentage points greater than the yields they're paying on the rated notes they've issued. The difference goes to investors holding

the unrated securities issued by the CLO; it's the premium they get for the risk of losing everything if the loans go bad. "It's highly levered and the risk that it will blow up totally," says Mark H. Adelson, a partner in structured finance search at Nomura Securities International Inc. Similar structures are all coming under the heading of collateralized debt obligations, and are being deployed to funnel billions into home mortgages and derivative investment-grade corporate debt.

### TRIPLE-A DEMAND

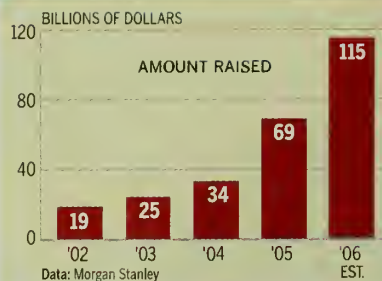
BY CARVING up the pool into different levels, CLOs have been able to corral billions of dollars from insurance companies, pension funds, and ultra-wealthy individuals around the world who crave rated investments—nothing less—over not loans to fund

"Now there's a whole new class of investors coming into the market," says C. DeVito, co-head of the Global Cash Group at Credit Suisse. Better yet, Ian H. Giddy, a structured finance consultant, "There is a virtually unlimited amount of capital to go into triple-A

That power to raise money has been lost on the buyout barons. They have started their own CLO operations not so much to fund their own deals but to get in on the action. Kohlberg Kravis Roberts & Co., the big LBO house, years ago started its own CLO, KKR Financial Corp., which it took public last year with a chief executive recruited from Wells Fargo & Co. Competing out giants Bain, Blackstone Group, Carlyle Group also have affiliates selling CLOs. They can see firsthand the immense capacity of investors to finance loans that in the past were held only by banks.

Buyout firms are benefiting from the momentum CLOs have built up since 2002. The vehicles have attracted investors by holding floating-rate assets that rise in years when short-term interest rates were rising. They've also looked

## Corporate Loan Pools Are Soaring





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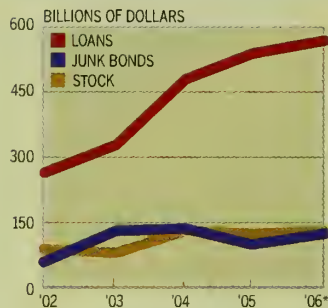
 **RBS**  
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## The CLO Ripple Effect

The hot CLO market is driving down prices for junk-grade loans. As a result, companies are choosing to borrow with lower-cost loans instead of raising money by selling junk bonds or stock. And private-equity firms are loading up large LBOs with debt while a larger share of junk loans is going to the lowest-rated companies. All of the money has brought down default rates, at least so far.

As loans raise more dollars...



\*FULL YEAR '06 BASED ON RATE OF ISSUANCE THROUGH OCT. 6

Data: Credit Suisse Leveraged Finance Strategy, Bloomberg Financial Markets, Loan Pricing Corp.

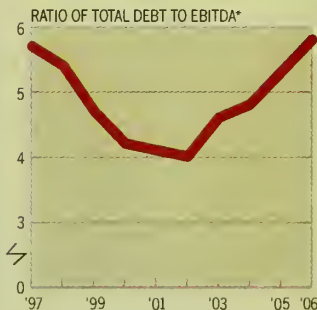
...borrowing costs decline...



\*BASED ON LOAN RATES B, B+

Data: Standard & Poor's LCD

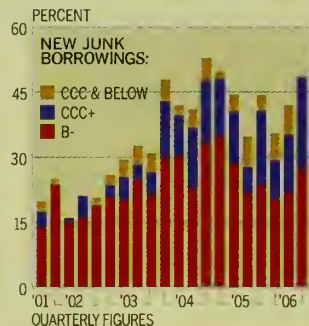
...and LBOs pile on more debt...



\*EARNINGS BEFORE INTEREST, TAXES, DEPRECIATION, AND AMORTIZATION

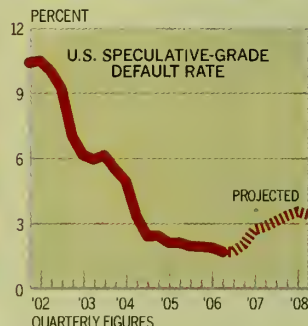
Data: Standard & Poor's LCD

...and the weak get credit.



Data: Standard & Poor's Fixed Income Research

But what's next for defaults?



Data: Standard & Poor's Fixed Income Research

because their loans are secured by the assets of the borrowing companies, which means they'll retain more of their value in bankruptcy than unsecured bonds, like those wiped out in 2001 and 2002 during a wave of defaults. By refinancing existing corporate debt on better terms and by supplying money for companies to heal and grow again after the last recession, CLOs have helped drive default rates down to 20-year lows. Hedge funds have added to the enthusiasm by loading up on junk loans. And the economy has grown, allowing companies to pay down debt and adding to the confidence of CLO investors. It's a virtuous circle. Things have gone so well, says one investment banker, that now smaller foreign commercial banks, notorious trend followers, are aggressively buying loans.

But the money is getting too easy for everyone's good. Some credit market veterans are starting to kick around the old banking maxim that the worst loans are made in the best of times. "Times are good, default rates are low, and you're probably seeing loans that in a few years will seem far too generous," says Louise Purtle, senior analyst at CreditSights Inc., a research ser-

vice for institutional investors. "You've got classic cyclical behavior happening right now." Mark L. Gold, co-founder of HillMark Capital, a CLO manager, says: "If you look at the record issuance [of loans] that's been done, clearly you're setting the stage for record problems."

### SHAKY FOUNDATION

THE IMMEDIATE CONCERNS are loans to auto industry suppliers, homebuilders, and suppliers to the homebuilders. Homebuilders alone account for about 5% of loans outstanding, big enough to matter but small enough not to panic the bulls.

Ultimately, loans made for LBOs could cause the most trouble. Those deals often come with risky business reorganizations. "You are more exposed to uncertainty," says Purtle, in a bet that "gets away from proven assets, proven management, and proven cash flows." With loans from the same big deals spread throughout CLOs, the chance of LBO defaults, says Gregory J. Peters, chief credit strategist at Morgan Stanley, "is the No.1 risk factor" to the CLO-fueled boom.

Worrisome signs are mounting. The amount of leverage used in deals right

now is greater than the previous record set in 2002, according to Standard & Poor's LCD, a loan tracker. And, like BusinessWeek's unit of The McGraw-Hill Companies. At the same time, loans are carrying lower ratings, with fewer safeguards, than at any time since the late 1990s. The worse mix suggests that in a recession of the order of the one in 2001, default rates would be more than four percentage points beyond the 12.8% set that year, Martin Fridson of SonVision, a research vice. Similarly, CLOs accepting more so-called second-lien loans, second mortgages, are backed by borrower assets, but their claim that collateral comes second. "Second liens could be the potential Achilles heel of the current cycle," says Gold, the manager at HillMark.

Another concern: managers' preoccupation with keeping the mix of loans in their pools to technical satisfy rating agency guides. Fundamental credit analysis of borrowers' ability to repay loans is being shortchanged, says Simon A. Mikhailovich, managing director of Eidesis Capital, a hedge group specializing in structured credit. In other words, investor diligence has been less than due: A pool of 85 deals may look good by the rating agencies' statistical and historical measures, but still hold bombs. "More and more there is an actuarial approach to credit analysis rather than the old-fashioned practice of looking each borrower in the eye," says Grant.

The full consequences of the CLO boom won't be known until business slows and borrowers can't raise more money to keep going. That may not happen for a while. S&P predicts that default rates will increase over the next 24 months, but remain under the long-term average. The reason: continued economic growth and strong liquidity in the credit market. Best would be for a gentle cool-down to give CLO fever some time to pass, but that's not likely to happen. Wall Street just doesn't work that way. ■

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## Why Conoco Still Gets No Respect

It has joined the ranks of Big Oil, but bets on higher energy costs give investors pause

BY BRIAN HINDO

**A**LTHOUGH IT HAS vaulted into Big Oil's ranks through acquisitions, ConocoPhillips is having trouble earning its seat at the table. Among the handful of supermajors, Conoco's \$183 billion in revenues rank behind only those of ExxonMobil, BP, Royal Dutch Shell, and Chevron, and they exceed those of Total. But its shares trade at 5.8 times forward earnings. That's cheap; Exxon trades at 10.7 times forward earnings, BP at 10, and Chevron Corp. at 8.1. For the year, Conoco shares are up 1.7%. That compares with 3% for BP, 15% for Chevron, and a 21% gain for Exxon.

So what's the company's crime? Acting like high energy prices are here to stay, it seems. Last December, Conoco raised eyebrows with its \$35.6 billion cash-and-stock acquisition of Burlington Resources Inc., a large natural-gas

producer. The deal was made expecting natural gas prices in the range of \$8 per thousand cubic feet, though they're closer to \$5 now. "They have been very aggressive with respect to their assumptions on commodity prices," says Mark Gilman, an analyst at Benchmark Co. "Management seems to be operating on assumptions that we believe are not only inaccurate but...potentially damaging."

Gilman's price target for Conoco stock is 47 a share, below its recent 58 and well below those of most other Wall Street analysts, many of whom expect the stock to rise past 70. Still, the Conoco discount is undeniable, and perhaps surprising for a company that has returned 116% to investors over the past three years—helping it land at No. 31 on the BusinessWeek 50 list of top corporate performers.

Conoco's low relative valuation has even attracted the eye of Warren E. Buffett, who disclosed a substantial invest-

ment earlier this year. But company investors on the v have been harder to imp That's in part because they'r necessarily as focused on gro After all, stocks in this secto be heavily swung by just factor: the price of oil. If it up, that's good for everyon it goes down, that's not but it's better for the ultra servative companies—Exxo example—that have low exp tions for the underlyingmodity prices.

### LOW PRICE, HIGH HOPES

CONOCO GETS dinged, as we its overall financial picture, v isn't as balanced as its bigger The Houston-based compa the No. 2 refiner in the U.S. as such moves much more o vagaries of gasoline prices. Co

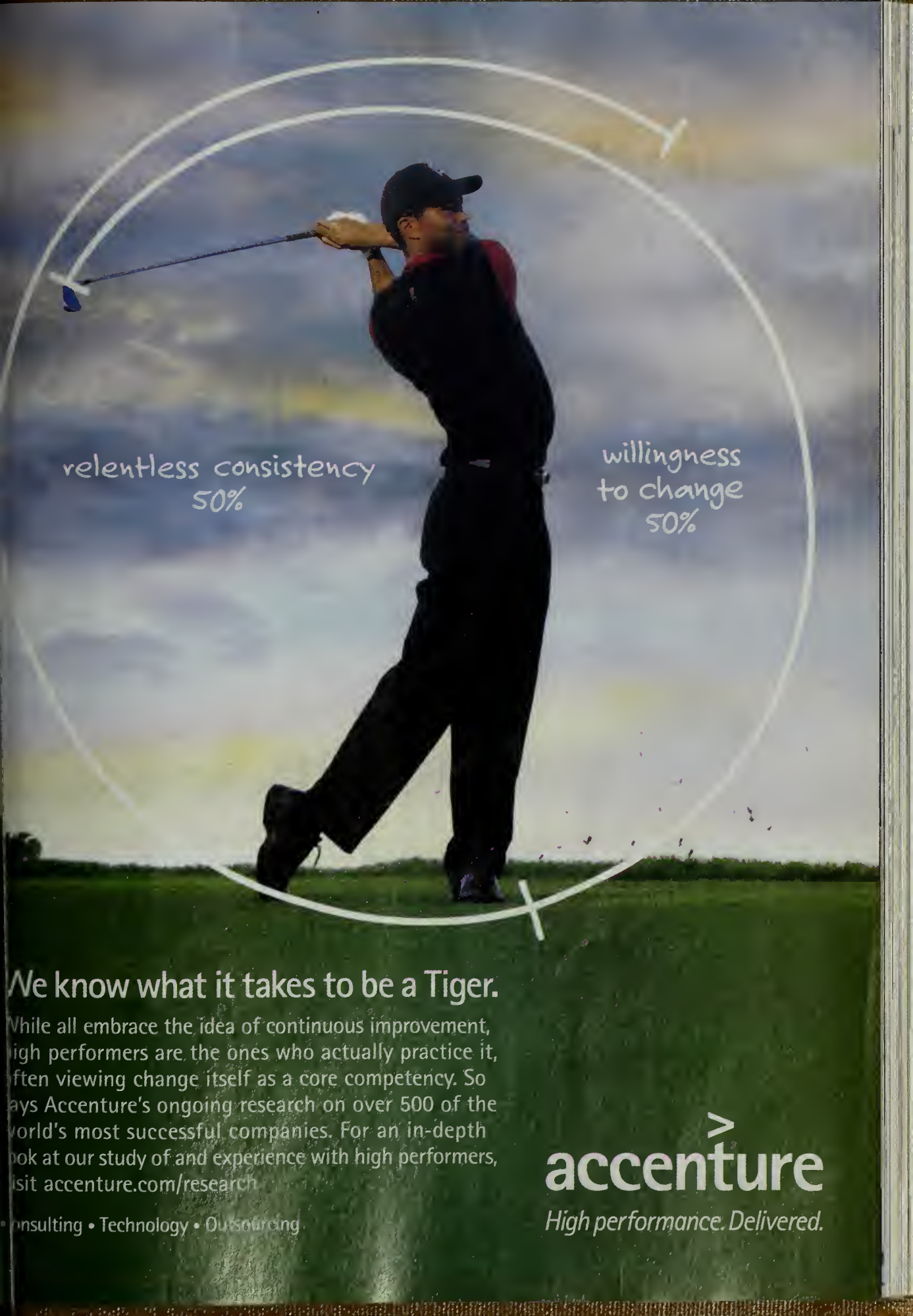
doesn't have the roster of exploration ects that some of the other majors c A.G. Edwards & Sons Inc. analyst Lanni figures it will have to rely on acquisitions and joint ventures to me 3% yearly production growth targets.

The laggard p-e ratio could make kering big deals tougher in the fi Conoco's market value is \$95 b which could only be considered : in the world of oil supermajors, v Exxon's value tops \$396 billion. But it is, especially with Conoco's debt a billion following the Burlington pur Although the company is cheap, it seen as vulnerable to a takeover, thar its heft and regulatory restrictions.

The company says it expects valuation gap to close over time a recent analyst call, Chief Exec James J. Mulva admitted that Con earlier forecast for natural gas wa He promised "more constrained" tal spending, and to bring debt c near \$20 billion in the next coup years. And if energy prices stay share buybacks may be in the offir

A lot of things will ha in this industry if er prices stay high. A conti seller's market for exp tion and production a could eventually vind Conoco's strategy. Ther be treated just like any old supermajor. "We saw the thing with Total," says Tina Vita equity analyst at Standard & P "Until the market got used to traded at a discount." ■





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# Time to Hit The Hard Stuff

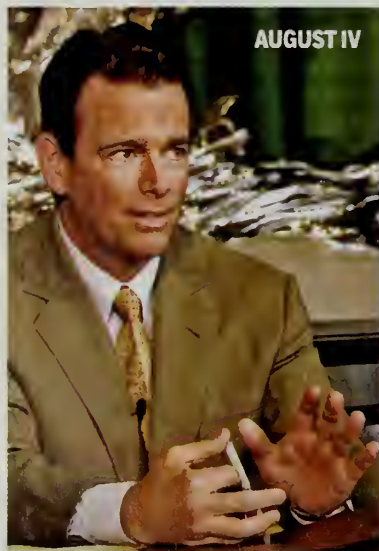
Faced with lackluster beer sales, Anheuser-Busch may buy a spirits maker

BY ADRIENNE CARTER

**C**OULD THE KING OF Beers become the King of Booze? The recent promotion of 42-year-old August A. Busch IV to CEO of Anheuser-Busch Cos., effective Dec. 1, has the industry buzzing that big changes are brewing at the beer giant.

Confronted with lackluster domestic beer sales, Busch IV—the great-great grandson of company co-founder Adolphus Busch and son of August A. Busch III, Anheuser's chairman until Dec. 1—has suggested at industry events over the past year that Anheuser may have to expand aggressively into the broader alcohol market. Now that he has ascended to the throne, industry watchers think an acquisition of a spirits company could be imminent. "Its 12 [U.S.] breweries can make anything, and it doesn't have to be beer," says Harry Schuhmacher, editor and publisher of *Beer Business Daily*.

Busch IV, who has run U.S. beer operations since 2002 and served in various roles at the company for 21 years, takes over during a rocky period for the beer industry. Wine and spirits have been steadily gaining share from beer over the past decade: Beer now accounts for 56% of the overall alcohol market, down from 60% in 1996, according to trade publication *Beer Marketer's Insights*. Sales volume for spirits is rising 3% to 4% a year, while beer has been flat. In 2005, Anheuser, the



nation's No. 1 brewer and maker of Budweiser, reported that net income fell 17.9%, to \$1.8 billion, the first such drop in a decade.

## THE RED AND THE BLACK

THE KING OF BEERS isn't a complete stranger to the world of spirits. It has been quietly testing its own liquor product, Jekyll & Hyde, since November through a subsidiary, Long Tail Libations Inc. The group's name is a nod to the Long Tail theory, which asserts that in today's era of viral marketing and Internet sales, a collection of small products can exceed the market share of a blockbuster.

Jekyll & Hyde—a 60-proof berry-flavored liqueur and an 80-proof herb-flavored black liqueur, packaged in nesting bottles—makes a nifty-looking shot, with the black liquid resting on top of the red Jekyll layer. The niche product, aimed at twentysomething barflies, allows Anheuser to test the logistics of shipping liquor through its massive distribution network and get a taste of how to market

effectively in the category. A major move into liquor could pack a serious financial punch. Profit margins on spirits, which are generally cheaper to produce, can be almost five times larger than on beer.

The company declined to say what, if anything, may be on its shopping list, but speculation includes some of the most well-known names in spirits. There's plenty of talk about Absolut, the world's third-largest liquor brand. The



**MONSTER MASH**  
Anheuser is testing its own liqueur

Swedish government has said recently that it wants to pry many of its liquor businesses, w

means V&S Group, maker of Absolut, be on the block. Another possibility is Bermuda-based Bacardi & Co., which owns Bacardi rum and Grey Goose vodka. Anheuser currently makes and distributes the Bacardi Silver malt beverage product in the U.S. Other names being bandied about are Brown-Forman Corp., Louisville-based distiller that makes Daniel's and Southern Comfort, and field (Ill.)-based Fortune Brands, which owns Jim Beam and Maker's Mark.

Adding hard liquor to Bud's portfolio seems likelier than buying another beer. Imports and craft beers have been in bright spots. But antitrust issues make it tough for Anheuser, which controls nearly 50% of the U.S. market, to move aggressively into those segments.

Some analysts suspect Anheuser could be a target. A merger with Budweiser InBev, which is larger in terms of volume but lacks a major U.S. portfolio, would create a massive global player. There are also rumors that hedge fund manager Eddie Lampert may be eyeing Budweiser. But that seems like a long shot. For now, there's no sign Busch IV is ready to give up the crown, having only just inherited it.

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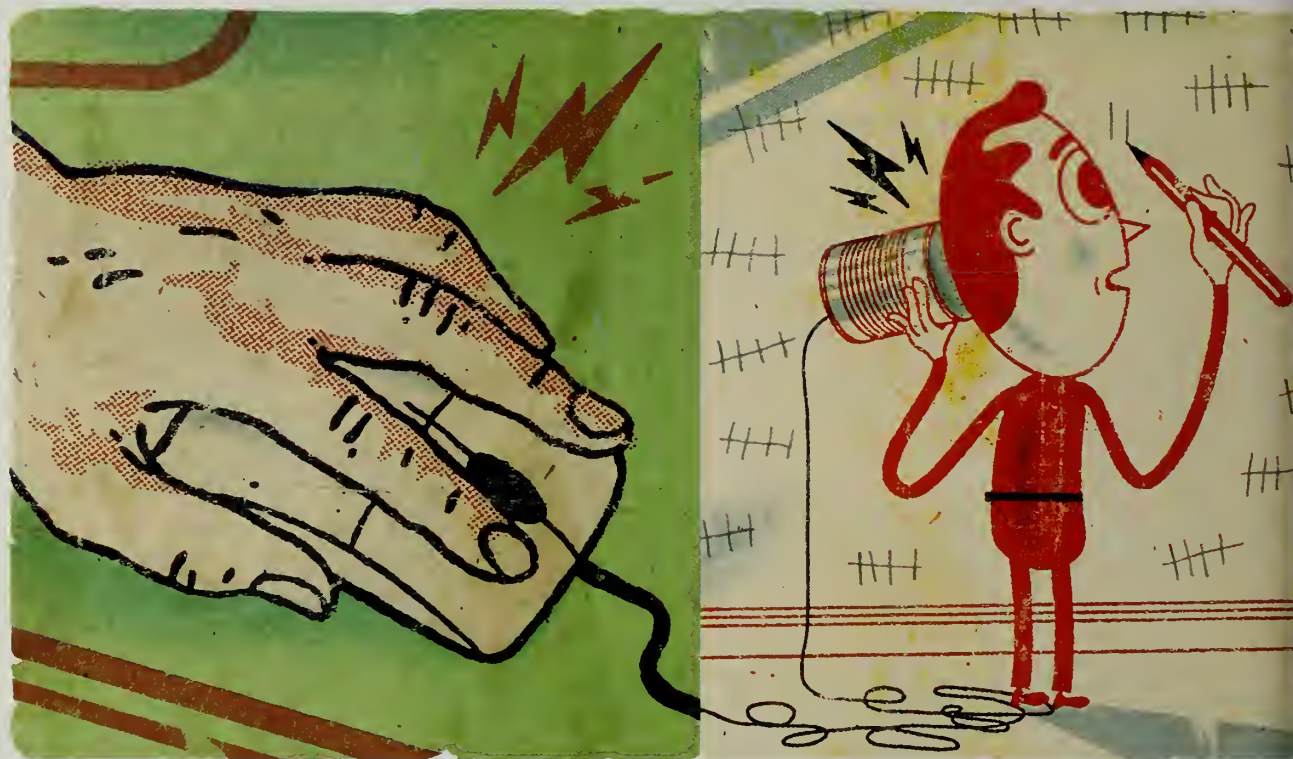


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# Web Numbers: What's Real?

Competing methods of measuring traffic online leave advertisers, investors, and even Net companies almost flying blind

BY SARAH LACY

**L**IFE IS GOOD FOR 27-YEAR-old Seth J. Sternberg. A year ago, he dropped out of Stanford Business School to work full-time on Meebo Inc., an easy-to-use service that has solved one of instant messaging's nagging problems: the inability to communicate with people who use an IM service other than yours. Today Meebo is going gangbusters. It has raised \$3.5 million from the Silicon Valley crème-de-la-crème, including Marc Andreessen of Netscape fame and venture capital heavyweight Sequoia Capital. More impressively, the service attracts almost a million people every day, who swap more than 60 million messages.

There's just one hitch: Sternberg and his co-founders have a hard time proving the site is as popular as they say it is. Look up Meebo's Web traffic using the comScore Networks Inc. service, and

you'll find that a European competitor eBuddy.com is four times as big. Alexa, a competing Web measurement service owned by Amazon.com Inc., shows Meebo is bigger. Which is true? Probably neither. Sternberg's best guess is that the two rivals are about the same size. Yet even he doesn't know for sure.

The dirty little secret of Silicon Valley is that no one knows exactly who is going where on the Web. That flies in the face of the impression that online advertising is the most dependably trackable ad medium of all time, a big reason spending on Web ads is expected to grow 33% this year, to \$16 billion. But confusion over traffic measurement could cast a chill over the Web 2.0 craze. Valuations for startups such as Facebook Inc. and YouTube

Inc. appear to be doubling ever months (page 34), but those numbers are based on traffic figures that be misleading.

From the start, measuring online traffic was a juggling act. Rather than relying on a Web site's traffic record, advertisers traditionally compared data with information from Nielsen NetRatings Inc. and comScore, independent services that recruit Web surf-

ers to record their mouse clicks. Those outfits argue there are many reasons to just count the clicks. Web site's server logs, for instance, comScore points out that servers don't count pop-up ads as a view if the tracking software didn't filter them out.

Independent traffic analysis becomes more important as bigger chunks

**Confusion over traffic figures could cast a chill over the Web 2.0 craze**





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## An Imperfect Science

Measuring online traffic is becoming increasingly tricky. All four methods have serious flaws:

### PAGE VIEWS

This industry standard counts the number of pages that people see. It's becoming obsolete because it can't take into account new publishing tools, such as Ajax.

### UNIQUE VISITORS

The number of people who visit a site. Sites and measurement services, which may not track new technologies or overseas users, can have conflicting data.

### REACH

Percentage of all Net users who go to a given site. A tracking service has to have a large representative sample size in order for this metric to be legitimate.

### TIME

Measures how long an individual stays at a site. This metric can be misleading, since people often leave multiple browser windows open on their computers.

advertising flow online and the threat of "click fraud," which inflates ad bills, grows bigger. No wonder that a host of newer services, such as Alexa and Hitwise, are highlighting the weaknesses of the older traffic-measuring companies and are muscling onto the scene with alternatives. By providing some free traffic data via their Web sites, these outfits make it easier for anyone to publish an estimate. But they also have their own blind spots and are making side-by-side comparisons vastly more confusing.

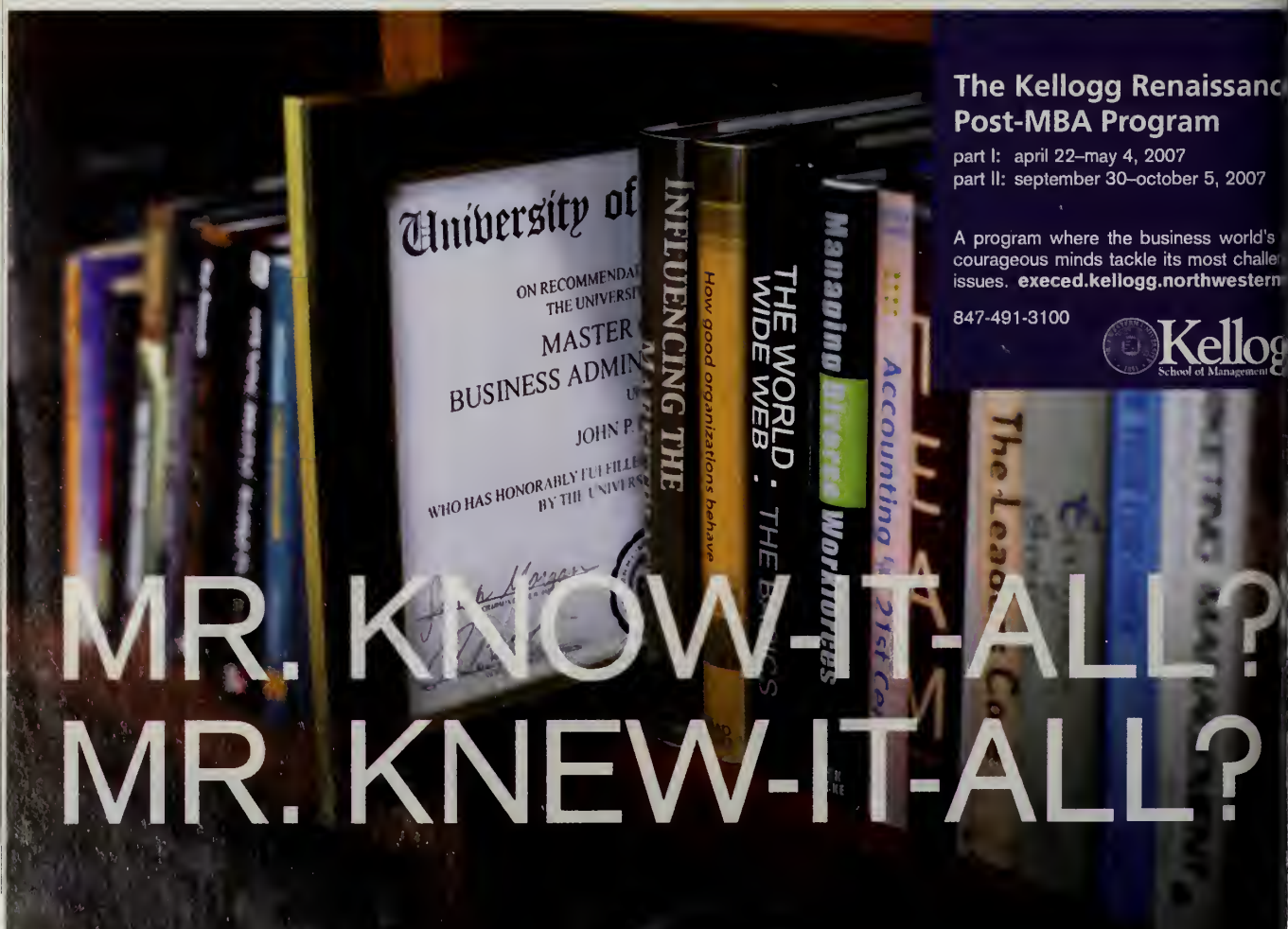
To see why there's an opening for new ways of measuring traffic, look at what has happened to the old standard for gauging online growth, the page view. As

the Internet evolved during the 1990s, advertisers came to rely on the number of pages a site served up each month as their most reliable metric. With the rise of new programming and distribution technologies, however, page views suddenly look less relevant. For instance, the beauty of a site such as Meebo is that it is built with software tools called Ajax, which speed up Web surfing. When you log onto Meebo, instead of loading a new page for every mouse click, only the log-in section is loaded. But no matter how long people stay on Meebo, they're technically viewing only one page.

Meebo isn't selling advertising yet. When it does, the company's executives

will be challenged to persuade ad buyers to consider measurements other than page views. In June, Sternberg invited comScore's researchers to his Palo Alto (Calif.) office to look at his company's server logs. "Here is our data, and it is your data. Something is wrong!" he told them, to no avail. Sternberg and his co-founders have thrown up their hands and have decided to publicly disclose all their internal numbers. One thing they're counting on is that people will take into account the amount of time members spend on the service.

Ajax isn't the only technology disrupting traditional Web measurement. Real Simple Syndication, or RSS,



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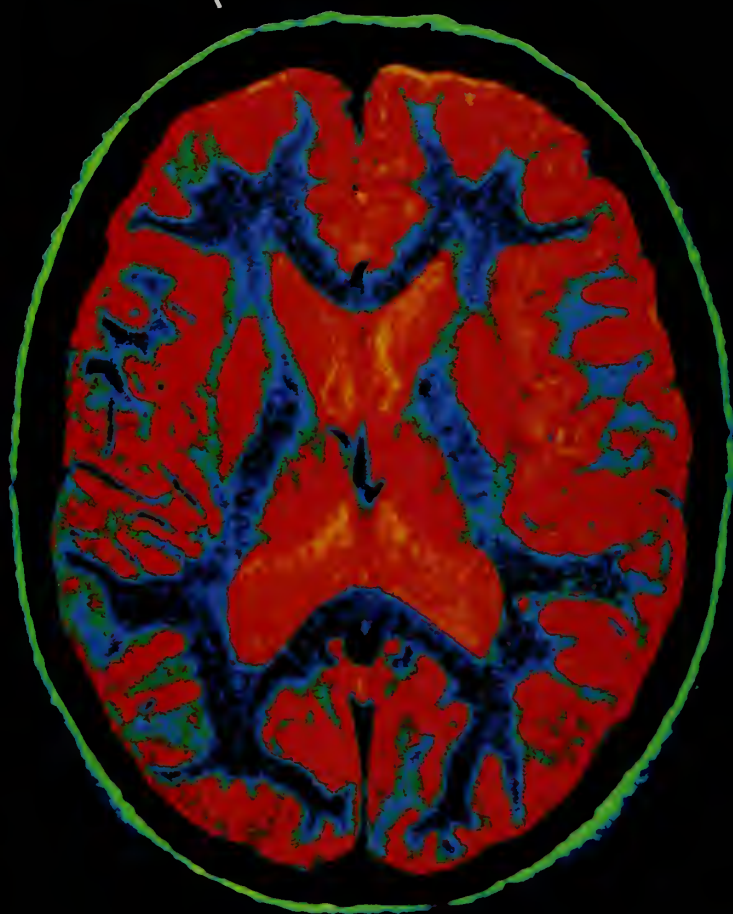
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ple sign up to have news articles, posts, or audio interviews from their favorite sites sent directly to their computers. But since they aren't surfing and, none of the sites gets credit for page view.

When there are widgets, interactive ads that can be installed on a wide array of sites. Install the Meebo Me widget on a MySpace page, and people can just click on that to IM you when they visit the site. More than 40,000 Meebo Me widgets have been installed. Because the widgets don't direct you back to Meebo's site, they don't show up in the Meebo traffic figures.

For advertisers, the problem is that there is no one method of measurement to capture certain Web technologies and demographics, it misses others. An alternative to counting page views, for instance, is to measure reach, which is the calculation of each site's usage as a percentage of all Net traffic. Alexa, which tracks Web surfers through a download-search toolbar, combines that approach with counting page views. But reach is limited because it compares reach among the sites its users visit. Results appear to skew more toward sites fa-

vored by techies rather than the wider Web, says Ed Sim, managing director of VC firm Downtreader Ventures. Niall O'Driscoll, Alexa's vice-president of engineering, says the company doesn't believe that's the case.

Web outfits seem to agree that Alexa is flawed, but they continue to rely on it because the data are so addictive. Since Alexa's numbers are free and available online, they can easily be plugged into a PowerPoint presentation or onto a blog, providing a quick-and-dirty way to get a competitive snapshot. Blogs cite Alexa as gospel, and its graphs are part of nearly every startup's pitch to investors. "It's a giant pain," says George Zachary of Charles River Ventures. "If someone came up with something better, I'd fund them."

## LIMITED PICTURE

IF ALEXA FAVORS early adopters and techies, the opposite complaint is made about comScore and Nielsen//NetRatings. Some VCs, startups, and established companies don't think these rat-

## Because of new Net technologies, traditional gauges can be misleading

ings methods adequately capture the growth of new services. Yahoo! Inc. saw this firsthand with del.icio.us, a Web bookmarking site the portal bought last year. ComScore showed declining traffic at del.icio.us over the summer, but Yahoo says it had at least 10% monthly growth.

The best hope for clarity is for Web ad giants and small fry alike to work with

the established measurement services to improve their tracking ability. ComScore and Nielsen//NetRatings are beginning to respond. ComScore, for instance, now reports the number of requested videos at online video sites, rather than page views or unique visitors.

Some observers expect that in time a variety of metrics, such as time spent online, will be applied to different services until one measurement that combines a set of factors can emerge. Until that happens, though, the Internet will have to deal with the discrepancies. And Web metrics, like company valuations, will remain a crapshoot. ■

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# This Mouse For Hire

Is click fraud a threat to online advertising or a short-term affliction? Our readers weigh in

BY BRIAN GROW

**S**earch giants Google and Yahoo! have built huge businesses around the millions who surf the Web—and the advertisers eager to reach them. But with companies pouring billions into pay-per-click advertising, just who is clicking on all those ads is a question keeping many marketing managers up at night. It was no shocker, then, that *BusinessWeek's* Oct. 2 Cover Story about the dizzying collection of scams and deceptions that inflate online advertising bills, "Click Fraud: The Dark Side of Online Advertising," struck a nerve and generated scores of online posts, e-mails, and letters.

Most respondents shared their own stories of "weird traffic,"

suspicious Web sites, and clicks that never convert into real customers. Others expressed surprise at the way Google and Yahoo say they have the click fraud problem under control. Some even wondered if the mine of pay-per-click advertising may turn out to be short-lived because of fraud concerns.

Still, more than a few dismissed the click fraud controversy (and questioned *BusinessWeek's* Old Media motives for investigating the New Media industry). Despite fraud, they argue, pay-per-click advertising still generates a much higher return on investment than the guesswork of offline marketing. Whether click fraud turns out to be a lasting curse or a short-term hiccup remains to be seen. In the meantime, here's a sample of what readers had to say:

Most academics and consultants who study online advertising estimate that 10% to 15% of ad clicks are fake, representing \$1 billion in annual billings.... In all, \$300 million to \$500 million a year could be flowing to the click-fraud industry.  
—from "Click Fraud"

ever perpetuated. But the extensive opacity that prevents meaningful explanation between invoices that always max out (to whatever monthly limit I set) and the extraordinary lack of client communication from any of these so-called searches has kept me away from investing in Google stock.

> Eric Uhlfelder, New York

The [pay-per-click] advertising business model seems strange to me. Usually, if I want to spend money on something, whoever wants to get a piece of the action has got to place a bid. I review the bids and reward the contracts to whoever gives me the best price-to-performance ratio. But in this [PPC] business, if I want to spend money on advertising, I go to Google, sign the papers, and whoever wants to bill me is welcome to do so. That just doesn't make much sense.

> Helen Shulkin, Fair Lawn, N.J.

Click fraud parallels the circulation scams in the newspaper industry and the notoriously unreliable measurement standards of television and radio, except that the Internet was supposed to be precisely measurable,

one click at a time. But how can any man measure a viewer's response, positive or negative? It is all blind faith, not science. It's about time faith got a good shake.

> Bob Mercer (businessweek.com)

I work as a Webmaster and use Google AdWords to attract traffic to my site. Fortunately, I don't need an MBA from a business school and specially designed software to discover what Mr. Fleischman has been curious about for three years: I discovered something wrong the first year I started using AdWords. A lot of weird traffic rushed into the site from China. I knew something was wrong and adjusted my settings to only use search keywords, relevant content [sites]. And I [now] expose my site only to users from my targeted market. After that, everything worked perfect. Though the traffic dropped a lot, I know I won't have trash traffic to burden my site.

> screen name: John (businessweek.com)

Thank you for your article! SEMPO (the Search Engine Marketing Professional Organization) has been watching and

None of what you exposed surprises me. I've been a Google AdWords client for several frustrating years. Like many small businessmen, I feel I have no choice. That said, I do not know if Google will go down in financial history as among the most clever business ideas or among the largest frauds





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measuring the industry's click fraud concern for several years now. SEMPO's mission is outreach and education about search marketing and to help sustain trust in search advertising media. The more transparency we can provide as an industry, the more easily fraudulent activity can be curtailed.

> Dana Todd, President, SEMPO

For over 10 years, I've been arguing that the search industry needs to acknowledge that click fraud is a real problem. [So] nothing in this report is a surprise to me. It just astounds me that the search engines and ad networks continue to paint a rosy picture of how they're on top of the problem.

> screen name: CPCcurmudgeon  
(businessweek.com)

Participants from Kentucky to China speak of making from \$25 to several thousand dollars a month apiece, cash they wouldn't receive if Google and Yahoo were as successful at blocking fraud as they claim.

—from "Click Fraud"

Everybody seems to be blaming the search engines for click fraud, but I believe that in order for the problem to be mitigated, we need to focus on the fraud committers instead. After all, if someone to whom you sent a postal solicitation called your sales line 500 times with no interest in becoming a customer, would you blame the post office or the caller?

> Eric Engel, Larchmont, N.Y.

The article is one-sided. It lumps all PTR [pay-to-read businesses] and members into one group committing click fraud. We have

those who are willing to be parasites if the opportunity is presented, but if the dog were bathed and groomed on a regular basis we wouldn't have the infestation. Is there a problem in PTR? Yes. Is it all of PTR? No. There are some very good sites trying to run legitimate businesses, just like the advertisers are trying to run businesses.

> screen name: concernedinptr  
(businessweek.com)

I think it's irresponsible for *BusinessWeek* to parade click fraud, a very real problem on some Web sites, as the poster child for all online advertising. Your cover design was intended to spark fear in the market, and your unnamed sources only served to fuel that fire without any evidence.

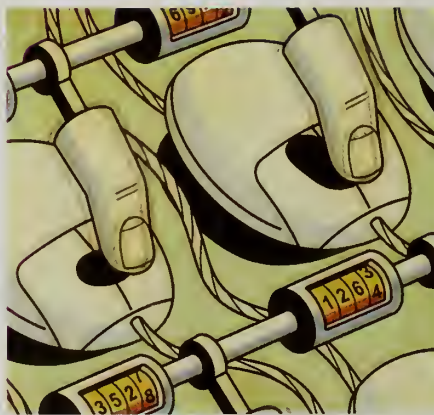
> Kathy Schwartz, Director, Internet Operations,  
Pocono Record, Dow Jones Local Media Group

Since I moved all my advertising from newspapers and magazines to the Internet, my business has increased almost 15% per year. To me this article sounds like a desperate attempt to regain lost advertising revenue by throwing dirt at the e-businesses.

> screen name: Businessman  
(businessweek.com)

To the person who says click fraud is no different than changing a channel on TV during a commercial—you missed the point entirely. Nobody can make money sitting at home changing the channel during a TV commercial. But people sitting at home can make a very nice income click-frauding.

> screen name: mrFG (businessweek.com)



"If we can't fix this click-fraud problem, it is going to scare away the further development of the Internet as an advertising medium. If there is an undercurrent of fraud, then...a large advertiser [may] not know how much it is losing."

—from "Click Fraud"

It's funny that these same companies [complaining about PPC transparency] would be willing to pay for a TV ad with way of really tracking who watches their (or if anyone does at all). It seems to me they're getting a much better deal. Even ZapMeta site's [experience]—1 customer less than 400 impressions? That's amazing odds. TV and radio still can't even come close to touching that. That's why Google and Yahoo can dismiss their unhappy customers.

> Tim Thomas (businessweek.com)

The opportunity for fraud from almost any advertising medium has existed ever since advertising was invented. Clicks and online tracking just make it easier to measure, not suggesting that every media outlet is fraudulent, I'm just saying that maybe click fraud isn't that big of a deal.

> John Jantsch, Duct Tape Marketing

While it is true there is waste in every advertising medium, one must make the distinction between waste and fraud. The proper analogy would not be someone changing channels during a commercial rather the cable company pushing advertisements to millions of "dummy televisions" that could not possibly be viewed by a potential consumer, and the advertiser being billed for those impressions.

> screen name: JP (businessweek.com)

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# Going Beyond Head Start

Programs that put real money into intensive preschooling pay off—in productive workers

BY CHRISTOPHER FARRELL

**T**O STAY COMPETITIVE, companies need an educated workforce. That's one reason executives wince at the sorry scores U.S. students earn in international reading, science, and math rankings. The results skew especially low for children from disadvantaged homes, and some education experts conclude that the quality of the American workforce will decline as the number of such households increases.

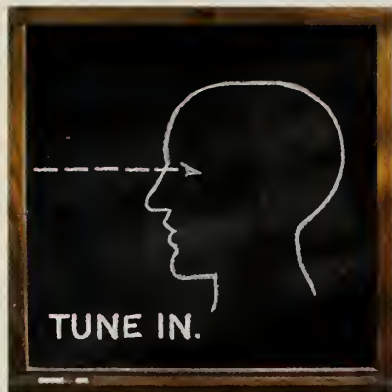
It doesn't have to be that way. Analyzing data from a series of long-term studies, a band of scientists, educators, and economists say that aggressive preschool training for children from troubled homes yields extraordinary dividends for the families and society. Waiting until elementary school or later doesn't pay off. With an early start, "all the evidence says that we can reduce inequality, and it's economically efficient," says James J.

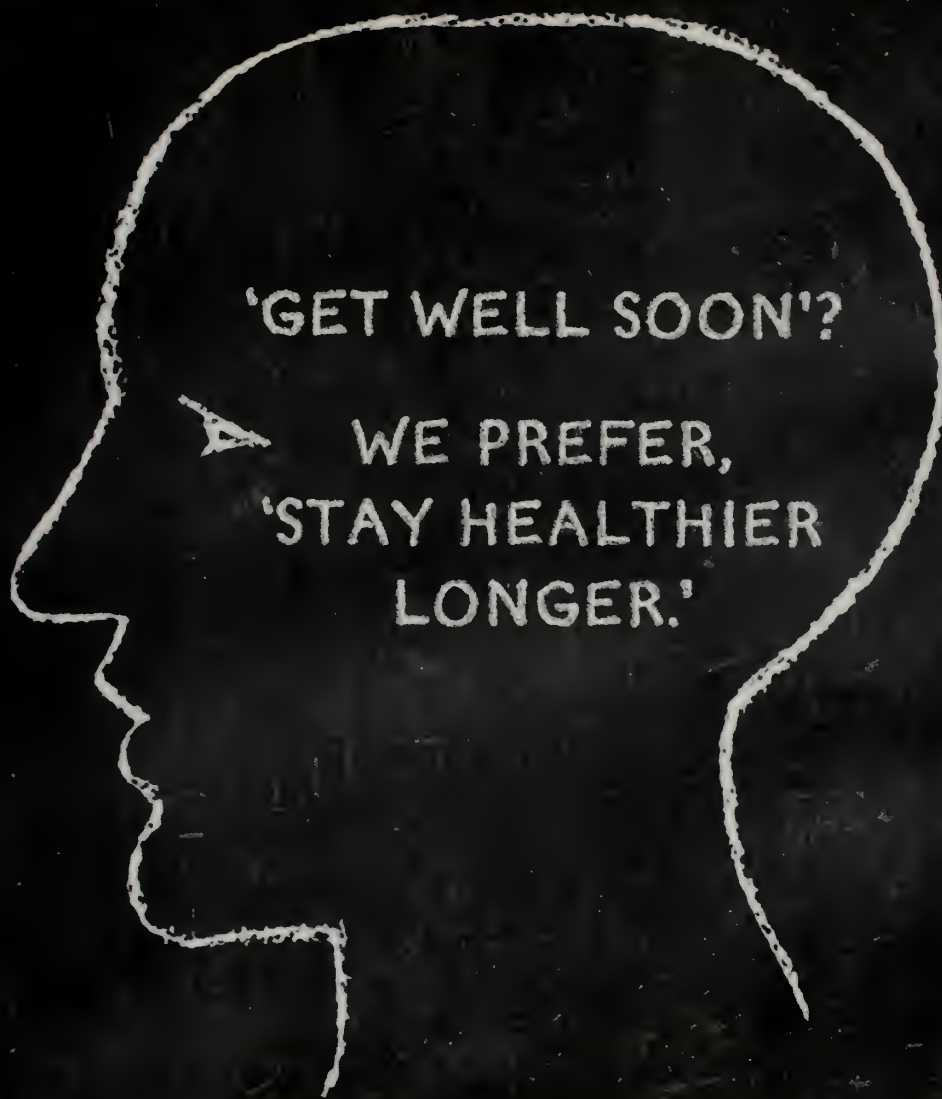
Heckman, Nobel laureate and economist at the University of Chicago.

Some of the most persuasive come from a 40-year, 123-child study of the High/Scope Perry Preschool Program in Ypsilanti, Mich. In 1962-67, preschool teachers worked intensively with 61 low-income African American children, ages 3 to 4, both at preschool and once a week in their homes. Such efforts don't come cheap: The High/Scope program cost \$10,600 per pupil, in 2005 dollars.

But 40 years later, when administrators compared the children's lives with those of 59 people who had not received special attention, the results were impressive. Almost half of the preschool children performed at the level of the control group by the age of 14, compared with 15% in the control group, and 60% were earning upward of \$20,000 a year in their 40s, vs. 40% in the control group. Throw in the higher number of grades completed, lower rates of criminal activity, reduced time spent in prison,

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## Social Issues Kids at Risk

and other factors, and the benefit-to-cost ratio comes to \$17 for every \$1 invested. "The research is overwhelming," says Arthur J. Rolnick, director of research at the Federal Reserve Bank of Minneapolis and an enthusiastic supporter of such programs. "It all comes down to 'the earlier, the better.'"

Numbers like these speak to business executives. In Minnesota, the heads of a dozen companies and institutions including Cargill, H.B. Fuller, and Best Buy are on the board of the Minnesota Early Learning Foundation. It will spend about \$25 million to finance pilot programs around the state, including experiments granting preschool scholarships to troubled families whose children face poor educational prospects. "They want the most cost-effective way to get at-risk kids ready for kindergarten," says Duane Benson, the foundation's executive director.

Programs such as these typically involve partnerships among businesses, nonprofits, and government. Take the ambitious projects funded by the Bill & Melinda Gates Foundation in Washington State and PNC Financial Services Group in Pennsylvania. The Gates Foundation is backing several experiments "to learn what works, and have a market-based approach to increasing the supply of high-quality care," says Greg Shaw, head of the foundation's early-learning initiative. The foundation plans to invest up to \$90 million on early intervention—assuming business and government are willing to invest, too. PNC is bankrolling a \$100 million effort over the next 10 years, working with groups such as Sesame Workshop, Head Start, and the YMCA.

### OWLS AND RATS

PROGRAMS SUCH AS Head Start also try to catch problems early on. But the new approaches go further, combining high-quality care and low child-to-teacher ratios, plus parental involvement. One approach Rolnick favors is giving parents scholarships and mentoring and then letting them choose the best program for their kids. The cost is about double the \$5,800 per student in an eight-month Head Start program. But the average rate of return on such an investment, says PNC Chief Executive James E. Rohr, is a high 16%, based on increased earnings later in life and less time in the penal system.

Advocates of early intervention support on the cutting edge of biology. It turns out the architect of an animal's brain is shaped powerfully by events early in life. In barn swallows, early experiences etch the neural circuits that convey auditory signals. Birds rely on to find mates, avoid danger, and target prey. With rats, when a mother intensively grooms her pups at birth, they exhibit less anxiety and are more adventurous than their neglected peers. Of course, you can't pre-

### The Preschool Payoff

In a 40-year study of 123 low-income children, intense preschool attention yielded big benefits. A sample

|                                     | PRESCHOOL GROUP                       | CONTROL GROUP |
|-------------------------------------|---------------------------------------|---------------|
| Met basic school requirements at 14 | 49%                                   |               |
| Regularly completed homework at 15  | 61                                    |               |
| Arrested 5+ times by age 40         | 36                                    |               |
| Earned \$20,000+ at age 40          | 60                                    |               |
| Benefit/cost ratio:                 | \$17.07 to \$1 for every \$1 invested |               |

Data: Bill & Melinda Gates Foundation, based on the High/Scope Perry Preschool Program

compare the experiences of owls and human babies, concedes Ivar Knudsen, a professor of neurobiology at Stanford University. But with intervention programs, "we are finding the same principles."

At a program called Families Together, run by the nonprofit Life Resources in St. Paul, Minn., the lessons go beyond reading and math. The preschool is housed in a former dealership with colorful murals on the walls, and the kids bubble with excitement. They arrive in the early morning, wash their hands, and sit down for breakfast. Yet the 50 families Lifetrack serves are anything but ideal. Most of the kids have had a parent in jail, spent time in foster care, and been exposed to violence, sexual abuse, or other hardships.

One of the toughest tasks, says time teacher Julie Nelson, is helping parents and children say goodbye when foster care is required. Yet Nelson says that with support and love, many of the children come through O.K. One of Nelson's students recently realized she was to blame for her father's violent behavior. The child explained that the trouble happened when her father failed to take his medicine. "We want to break the intergenerational cycle of abuse and help the children develop a sense of worth," Nelson explains. ■



AARP

# The Coming Retirement Wave

**Enlightened employers are making strategic business decisions in addressing the needs of an aging workforce by increasingly providing flexible work arrangements that accommodate the schedules of the employees and their families."**

**BILL NOVELLI, AARP CEO**

American companies are still recovering from globalization, technological change, and hypercompetition that rocked their financial foundations during the past two decades. But a new, hidden force is already cascading toward them threatening to shake corporate structures even more violently, this time from the inside out.

That looming force is the retirement of the "baby boom" generation, and like the macroeconomic changes before it, these impending workforce changes will compel companies to innovate, adapt, and even remake themselves if they are to survive.

## >> The Looming Retirement Wave

The raw numbers paint a vivid portrait of the demographic shift bearing down on the American workforce. This year, the oldest of America's 78 million baby boomers turn 60 years old. The baby boomers constitute more than 40% of the entire U.S. labor force, and still higher percentages of many firms' executive and managerial ranks. As large numbers of workers retire or cut their work schedules, corporations will have to manage an inevitable brain drain, driving up labor costs and depleting corporations of vital knowledge, talent, and institutional memory.

Although long forecast, these workforce changes have typically been regarded as only human resource issues. But companies that hope to ride the retirement wave need to recognize it for what really is: a powerful strategic threat that has the potential to undermine firms' productivity and competitiveness for years to come.

According to a just-released AARP survey conducted by BusinessWeek Research Services, most businesses have not accepted this new workforce reality. Some 44% of the more than 1,000 business executives who responded to the online survey "strongly agreed" that workers nearing retirement would play a growing role in the U.S. workforce over the coming decade. But a mere 22% "strongly agreed" that these trends would affect their own organizations, and only 20% were "very concerned" that their own companies could lose valuable knowledge and experience in the process.



## >> Inadequate Planning

One startling consequence of this viewpoint is that just one in three executives in the AARP survey (32%) said that their firms had ever attempted to quantify the costs associated with employee turnover. And fewer than one in ten (8%) said that their organization had formal practices in place to extract important business knowledge from their retiring employees. The lack of planning is especially surprising since the vast majority of executives acknowledge the value of older workers'

knowledge and experience and report that they are already experiencing difficulty finding qualified new workers. Specifically, more than nine in ten executives (93%) say that it is "very" or "somewhat" challenging to find qualified workers who have the experience and skills they need. Furthermore, nearly eight in ten (79%) "strongly" or "somewhat" agreed that the knowledge and experience that older employees take with them when retiring can hurt a business financially.

## >> Preparing is Key

Executives who take steps now to prepare for the aging of the workforce will help their businesses avoid potentially significant losses in talent and productivity. Many executives already acknowledge the value that 50+ workers offer. For instance, 40% of the respondents ranked customer service and customer retention as their organization's number one priority. And a stunning 91% agreed that experience—a key factor in customer satisfaction and retention—was an important advantage of workers age 50+ as compared to younger workers. A full 63% report that another advantage of workers ages 50+ is the valuable insight that they offer into customer needs and business needs.

These are essential realizations that will help companies to connect the dots between older workers' skills and experience and their dramatically positive effect on corporate productivity, competitiveness, and profitability. Acting on these realizations will be the next step. Far-sighted executives who wish to remain competitive need to begin changing corporate attitudes in order to lead their companies through the demographic changes ahead.



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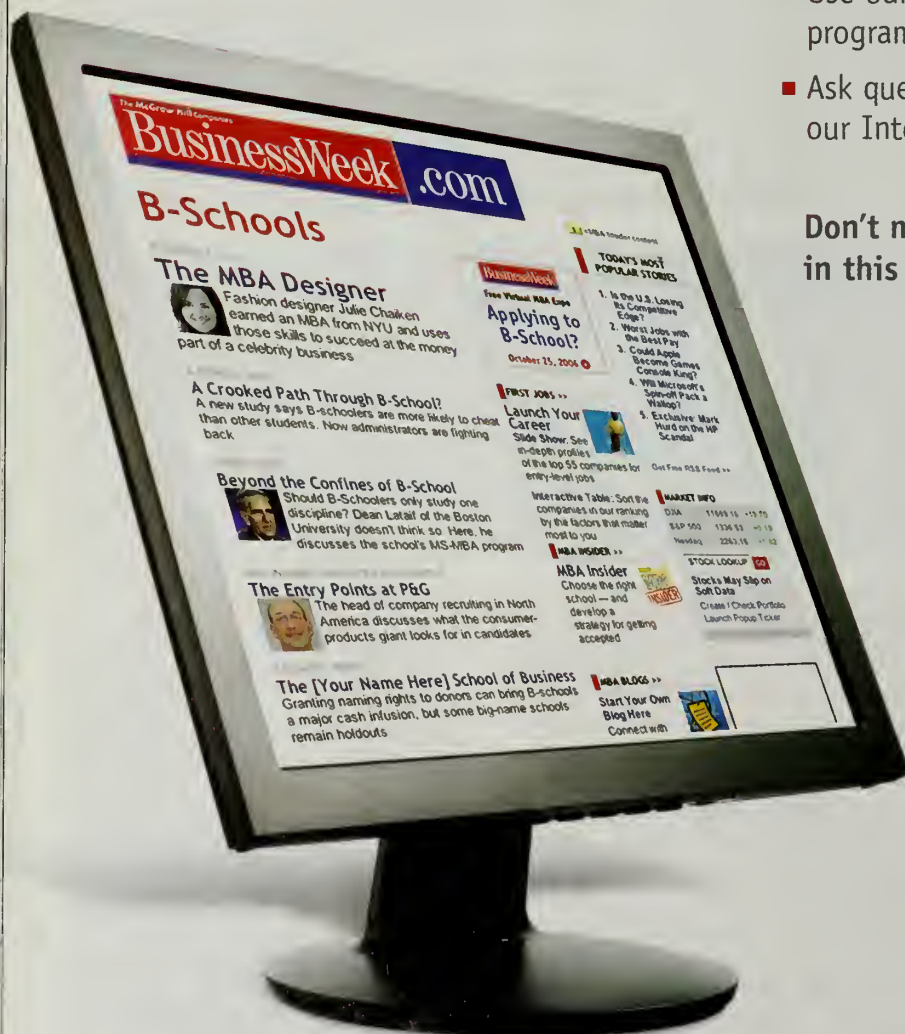
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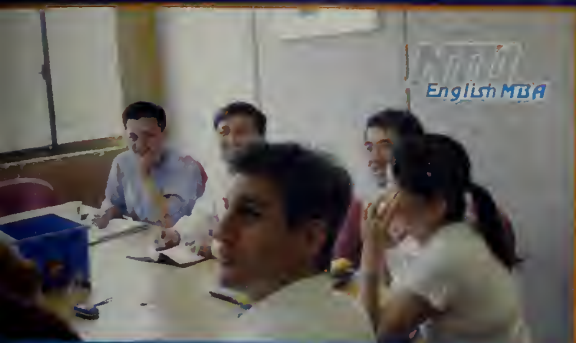
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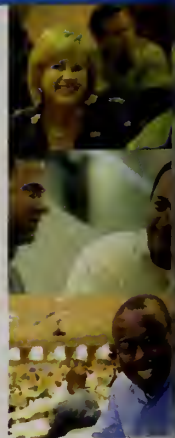
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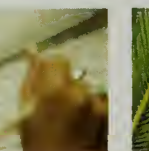
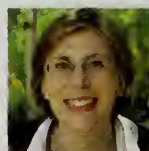


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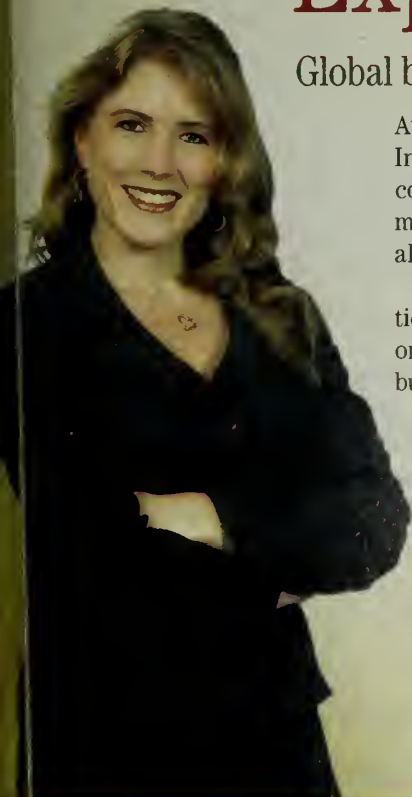
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**OUT OF THE TRAP**  
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# The Golf Bug Is Biting Japan Again

Goldman Sachs and other investors are cashing in as the Japanese start spending serious yen

BY ROWLEY

NEW THINGS BETTER SYMBOLIZE the crazy, speculative excesses of late-1980s Japan than golf. Memberships at the best clubs pushed \$4 million, and scores of companies—from small-time dealers to blue chips such as Matsushita Electric Industrial Co.—built or bought clubs all across the archipelago. Like other assets, memberships traded freely and valuations soared. The *Keizai* daily even came up with a membership price index that links golf club values as closely as stock tables. But all came screeching to a halt in the early 1990s, when Japan's economy foundered like a Sahara-sized sand trap. Plumland values wiped out many owners, and by 2003 the *Keizai* index had dropped by 95%.

But now that Japan's economy has started to recover, golf is making a comeback. The *Keizai* index is up 37% over the past 12 months, and new money is pouring into the sector. Visitors teeing off at 12,400 golf courses increased 2% last year through March, after falling by 1% in the four of the past six years. Meanwhile, the number of rounds played in Japan has stabilized at around

80 million per year, though that's still well below the 1993 peak of 100 million. In the bubble years, "people were buying golf memberships as investments, but now they're buying them because they want to play," says 58-year-old golfer Kunio Shimada.

The turnaround is likely to mean big profits for two unlikely investors. Investment bank Goldman Sachs Group Inc., which spent sizable sums acquiring failed golf courses in Japan earlier this decade, is cashing out. On Nov. 1, Goldman plans to sell shares in its Accordia Golf Co., which now owns 91 courses. Although golf looked like a bizarre bet back when Japan was in the doldrums, it looks smart now as the share sale may raise as much as \$1 billion. And U.S. private equity house Lone Star Funds raised about \$340 million last year when it sold shares in Pacific Golf Group International Holdings, which is Japan's biggest golf company, with 99 courses.

In addition to the economic turnaround, the golfmeisters have demon-

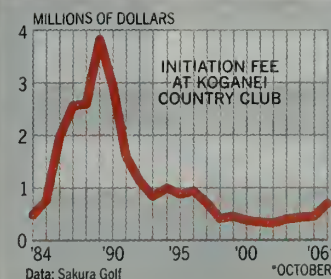
graphics working in their favor. Japan's cash-rich baby boomers are about to retire. By 2010, Japan's sixtiesomething male population will jump by 22%—to 8.7 million. And while men are nearly six times as likely to play golf as women in Japan, more women are taking up the game. "Playing takes concentration, and you forget everything but golf," says Hiroko Asami, a 60-year-old who got the golf bug four years ago. For her membership at the Itsukaichi Country Club 50 miles west of Tokyo, she paid \$8,500—about one-tenth what it would have cost during the bubble.

Although prices have fallen, Japan's 11 million golfers are still willing to spend serious yen to get out to the tee. Membership at the hyperexclusive Koganei Country Club in suburban Tokyo will set you back a cool \$680,000—down from a peak of \$3.8 million in the bubble years, though still outrageous for the typical golf-loving salaryman. Even less expensive clubs are able to raise their prices. "An increasing number of individuals are now prepared to pay membership fees of \$25,000 or more—a big change from a year ago," says Yaeko Sagawa, president of Sakura Golf, which trades golf club memberships.

That's helping the bottom line of golf course operators. Pacific Golf Group expects profits of \$77 million on sales of \$565 million this year, up from earnings of \$33 million and revenues of \$517 million last year. And Goldman's Accordia is projecting net profits of \$86 million from sales of \$574 million this year, compared with \$37 million on sales of \$366 million last year. Not a bad score. ■

—With Hiroko Tashiro in Tokyo

## BACK TO THE FAIRWAY





# How to

**A** well-cut man's suit is one that's well cut for the man who's wearing it. Sure, lapels widen and narrow, cuffs appear and disappear, but elegance and proportion are timeless. Cary Grant still looks terrific in this circa 1940 suit.

Yet wouldn't Grant look great in any suit? Not necessarily. The weight of the cloth adds bulk to his thin frame. And tailors widened the shoulders to make his larger-than-average head look more normal.

Learn what works for you, and dress accordingly. Clothes can mitigate whatever shortcomings you may feel you have. They can make you look taller or thinner, but not tall or thin. Chef Paul Prudhomme in a well-tailored suit will not morph into Paul McCartney; Paul Sorvino, maybe.

Know what body type you have, and take this advice when choosing your style.



# Well-Suited

Double-breasted or single?  
Two buttons or three?  
Checks, stripes, or solid?  
Here's how to choose a  
style that flatters your  
physique

**BY NICHOLAS ANTONGIAVANNI**

## Thin Guy

If you, tailored clothing works especially with your form, and you can pretty much anything you want look great. It suffices to mention Fred Astaire. If you're worried about looking too thin, wear flannels and tweeds. You can play on the accessories: pocket squares, tie clips, and the like. Clothes with a little extra fullness or "drape" can carry you out, though if you're young you might enjoy wearing those slacks that cut—while you still can.

## Short Guy

One way to look taller is to wear a jacket and trousers from the same manufacturer. Sports jackets paired with pleated slacks break the body in a way that is usually. The sum of the two parts is much less than a single line. An expanse of identical cloth is better than a cuff. So best if that single line is dark and light. Look, for instance, at

the diminutive Peter Lorre, clad in a dark suit in *The Maltese Falcon* vs. the light suit he wears in *Casablanca*. The dark clothes draw much less attention to his height—or lack of it—than the light clothes.

As for patterns, none is best, though stripes—provided they are thin and close together—can help or at least not hurt much. If you love plaids, take care that the vertical aspect of the box is noticeably longer than the horizontal.

Another useful trick is to wear smooth cloth, like most business suits. Flannels and tweeds add unnecessary bulk—and the wider you

look, the shorter you look. Similarly, it's best to keep details to a minimum. Ticket pockets and trouser cuffs add style but don't help the short man appear taller. Rather, their absence adds a bit of illusory height.

You can cut loose with your shirts and ties, because these affect your overall look much less than the suit. But if the main thing you want your clothes to do is mask your diminutive stature, then it's best to keep them simple: solids or discreet stripes. Shoes should not obviously stand out from your trousers. Black or dark brown will go with just about any dark worsted cloth.



Nicholas Antongiavanni is the nom de plume of a White House speechwriter who now has a new job in New York City for a major magazine. He is the author of *The Suit: A Modern Approach to Men's Style* (Simon & Schuster, \$18.95).



## The Tall Guy

It's good to be tall, or so most men think. However, it is not good to appear overly tall. To avoid too much of a good thing, the tall guy needs to dress the opposite of the short guy. If you're tall, odd jackets and trousers generally look great, as do light colors. However, there will be some occasions in life for which only a dark suit will do. In that case, if the weather is cool, choose a flannel or something with a little surface interest to build you out. Double-breasted is a great look for the tall guy, a three-button suit that buttons to the top is just about the worst.

Details are your friend. Coats should have pocket flaps, trousers should be pleated and cuffed, always stick a handkerchief in your breast pocket, and wear busy shirts and ties (though not both at once). You can also play around with lighter-colored shoes to advantage.

To see the result of flouting these guidelines, look no further than Conan O'Brien. David Letterman, by comparison, gets it right.



## The Double-Breasted Suit

The double-breasted jacket is a stylish classic that a lot of men of all shapes will—and should—want to wear, provided you wear the right kind. The critical factor in the double-breasted suit is how the jacket buttons are placed. You want them to be somewhat high and close together. Higher is more elongating, closer together more slimming.

The contrast between Harry Truman and Humphrey Bogart shows this



clearly. Truman, a haberdasher before entering politics, wore double-breasted suits unsuited to his frame: button stance too low, and too spaced out. He looked like a fire plug. No wonder his clothing business failed. On the other hand, Bogart—or his tailor—knew what he was doing.

## The Three-Button

The question of how many buttons a suit should have is one that clothing obsessives have debated for decades. Those who like three buttons, it's best to stay away from the kind that buttons all the way to the top. These look bad on everyone, in my opinion, but particularly bad on tall men like Conan O'Brien. In the front, when closed, it creates a vast expanse of cloth across the chest, which conceals all variation and presents a uniform visage. Two-button coats show more variation and break up vertically.

Instead, go with the Italian favorite "2½" or the "roll through." This has three buttons, but the top one is not meant to be fastened. The line of the lapel ends halfway between the middle and top buttons. Thus, you get the best of both worlds: a longer lapel line than a true two-button, yet the extra length implied by a three-button front.

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## The Muscular Guy

If your muscles leave no doubt that you're a gym rat, remember that most tailored clothing is built to mimic a body shape you already possess. You're best served by jackets with minimal shoulder padding and soft fronts. Overly structured coats can make you look like an appliance. Scale is also important. Avoid narrow lapels and skimpy collars; you're big, and the constituent parts of your clothes need to reflect that, so skip the Rat Pack suits.

You also want the coat to conceal as little of your torso as possible. The more cloth wrapping around you there, the more you look upholstered. Two-button coats are good at showing shirt and tie, as are three-button coats, as long as you don't button them to the top. You also want to choose a cut that is open, with fronts that hang below the button flaring away.

Keep everything else simple: solid shirts, discreet ties, and dark shoes. You can have some fun with lighter colors, if the spirit moves you, but avoid loud plaids. Arnold Schwarzenegger is a good example of a muscular guy who does pretty much everything right.



## The Heavy Guy

Carrying those extra pounds means you want your cloth to be as unobtrusive as possible. That is best accomplished with dark, smooth worsteds. If you are partial to patterns in cloth, you can choose stripes, but only if they're muted. Three-piece suits can also work well for you because the vests hide bulky bellies.

The most important thing is not to wear tight clothes. It may seem counterintuitive, in that looser clothes mean more cloth and thus more bulk. Rather than make you heavier, extra material will allow your clothes to lie smooth. Check out Jackie Gleason in *The Hustler* to see what I mean.

## Look Like the Great

Well, maybe not. But at least you can patronize some of their tailors.

**Fred Astaire** was a devoted client of **Anderson & Sheppard**, the home of soft, drapery tailoring since 1906, 32 Old Burlington St., London, 44 20 7734 1420, [www.anderson-sheppard.co.uk](http://www.anderson-sheppard.co.uk)

Figures as diverse as **Cary Grant** and **Jackie Gleason** favored the clean lines of Savile Row's **Kilgour French & Stanbury**, 8 Savile Row, London, 44 20 7734 6905, [www.kilgour.eu](http://www.kilgour.eu)

**Gleason** was also known to frequent **Fioravanti**, 45 W. 57 St., New York, 212 355-1540, [www.williamfioravanti.com](http://www.williamfioravanti.com)

**David Letterman** is a devotee of **Nino Corvato**, 420 Madison Ave., New York, 212 980-4980

**Arnold Schwarzenegger** has suits made by **Giacomo Trabacchi**, 732 North La Cienega Blvd., Los Angeles, 310 652-6396

I would be remiss if I didn't mention two of my personal favorites: **Savile Row by Raphael**, 509 Madison Ave., New York, 212 888-6887, and the itinerant **Frank Shattuck**, 315 882-4

**BusinessWeek online** For a look at fall suits, watch *BusinessWeek Weekend*. Check local listings or go to [businessweekweekend.com](http://businessweekweekend.com) for more information.



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# ...Martina Navratilova

Here's how the tennis superstar plans to stay "functionally fit" in retirement. **BY AMY DUNKIN**

**N**OW THAT MARTINA NAVRATILOVA has re-retired from tennis, she swears she's not going to make the same mistake again. "The first time I quit in 1994, I got lazy. I put on some pounds, I was sluggish, and the less I did, the less I wanted to do," she told me recently as we rode from a taping of the *Today* show in Midtown Manhattan to lunch at Bonobo's, a vegetarian raw food restaurant on East 23rd Street. "I had all this time to do all these sports, but I didn't have the energy to do them."

Looking today at the fabulously flabless woman who most sports fans know simply by her first name, it's hard to conceive of Martina having weight issues. It just proves that it really does happen to the best of us. Of course, Navratilova, who turns 50 on Oct. 18, is in better shape than most people half her age, and she's determined to stay that way in this next phase of her life. "I'm not going to be crazy in training, but I'm going to be functionally fit, so I'm not limited by my lack of fitness," says Navratilova, who exited tennis

on a high note by winning the 2000 Open mixed doubles championship with partner Bob Bryan on Sept. 9. It was her 59th Grand Slam title of her career.

While on the professional tennis circuit, Navratilova spent countless hours in gyms doing strength and flexibility training. Now she plans to do more of a mix and matching of different techniques. Among those in her repertoire are Pilates, and gyrotonics, which emphasize circular motions rather than more abrupt linear ones. She also uses simple, inexpensive equipment such as resistance bands and exercise balls, which she shows in the routines she created for her recent book, *Shape Yourself: A Step Diet and Fitness Plan to Achieve the Best Shape of Your Life* (Rodale).

But her passion is sports, and she seems to engage in nearly every endeavor you can think of, including, ice hockey, skiing, and snow

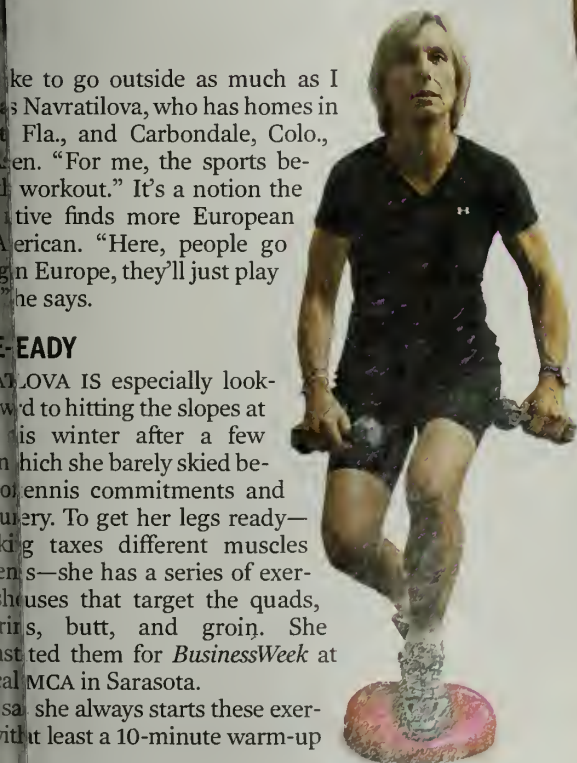
## HAMSTRING

**CURL** Lie on your back with your feet on a fitness ball. Extend your legs so the ball rolls under you, then bend your knees and roll it back.



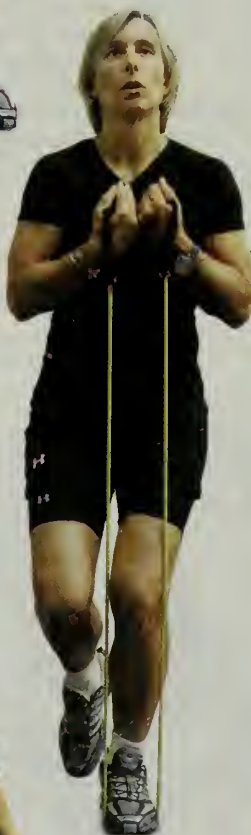
## LATERAL LUNGES

Holding a weight in each hand, bend one knee to the side and stretch the opposite leg. Keep the weight in the opposite hand in the center.



## ONE-LEGGED SQUATS WITH BAND

Hold the band taut as you do the squats. Pull up on the band to increase the difficulty.



## BALANCE EXERCISE

Stand with one foot on air-filled balance disk. Bend your standing leg. To make it harder, hold weights in both hands.



## Martina's Pre-Ski Workout

Exercises are done in two sets of 10-12 repetitions up to three times a week.

- 1 Warm up on a stationary bike or treadmill (10 min.)
- 2 Knee bends standing with one leg on a bench and the other dangling; hold a 10-lb. weight\* on the same side as dangling leg, while the other hand grabs a bar for support
- 3 Forward lunges with top of foot on a bench or chair behind you
- 4 Leg presses on machine where you lie on your back
- 5 Hamstring curls lying on mat, extending and bending legs over large fitness ball
- 6 One-legged squat standing on resistance band
- 7 Balance and squat on one foot while standing on small balance disk and holding weights
- 8 Front and side lunges holding weights
- 9 Sit on mat, knees bent, legs slightly raised; hold medicine ball at waist level and move from side to side (or throw to a partner)
- 10 Leg stretches on mat: Sit and touch toes; lie down and pull alternate knees to chest; bend knees and rotate legs from one side to the other (10 min.)

\*If you're doing these for the first time, start without weights. Gradually add different size weights as you get stronger.

on a stationary bike or treadmill (table). She typically does two sets of 10 to 12 repetitions for each, and rather than piling on more sets or reps to increase intensity, she prefers to add weights or pull the resistance band tighter. She begins her routine with a move she calls the "Landis Lunge," named after strength trainer James Landis, whom she worked with in Aspen. In it, she does one-legged knee bends holding weights and standing on a bench. After seven other exercises, she cools down with leg stretches. Navratilova cautions that anyone doing these moves for the first time should take it easy by starting without weights and limiting the number of reps. ■





# What's Sizzling In Minneapolis

## BY CHRISTOPHER FARRELL

If your next business trip takes you to Minneapolis even in the dead of winter, don't despair. A handful of star architects backed by a \$500 million-plus building boom has transformed Minneapolis into a year-round cultural mecca. So there's plenty to do and see while you stay warm.

1

### Guthrie Theater:

Internationally renowned French architect Jean Nouvel created a dramatic industrial twilight-blue steel building for the Guthrie alongside the Mississippi River. The new facility, which opened in June, offers three venues: a 1,100-seat theater with a large stage that juts into the audience, a 700-seat space draped in deep



red, and a 200-patron black box for more experimental fare. The Guthrie welcomes

wanderers without tickets who can enjoy ground-floor restaurant, café and bar upstairs, and a drink at the many stations. A highlight for the visitor is the foot cantilevered promenade that overlooks the city and the Mississippi.

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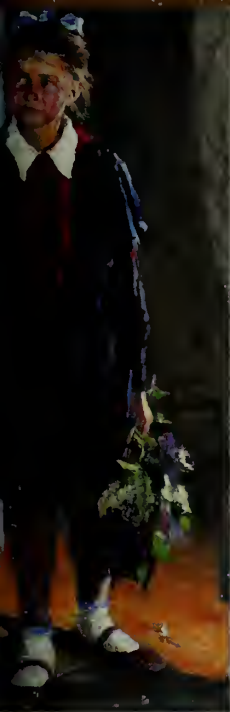
Schnucks



GIANT

Tops





collection of Soviet realist paintings in America, including Fedor V. Shapaev's *Young Pioneer at the Door* (left). The museum moved to this location in 2005 and features art owned by businessman Raymond E. Johnson, who went on a buying spree during *glasnost*.

3

#### Walker Art Center:

The recent expansion of this avant-garde museum by ultramodern Swiss architects Jacques Herzog and Pierre de Meuron reflects the Walker's artistic ambitions. The Center is a large, irregular cube sheathed in an aluminum metal mesh skin. Chef Wolfgang Puck's food empire runs the museum's high-end 20:21 restaurant and bar.

4

#### Mill City Museum:

Minneapolis used to be called Mill City when it dominated the global flour business at the turn of the 20th century. The old Washburn A Mill was a big part of that history. Gutted by fire in 1991, it was restored as a museum with a dramatic outside courtyard in 2003. Who knew making flour could be so fascinating? In the 30-seat "Flour Tower" ride, when the elevator stops at different floors, you can learn about all aspects of mill life.

5

#### Minneapolis Central >>

**Library:** The most striking element of this airy new library designed by Argentine-born Cesar Pelli is the soaring five-story atrium. After admiring the Minnesota limestone floors and glass



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SNYDERS





BY ROBERT PARKER

# The Central Coast's Rhône Rangers

Over the past decade winemakers have been planting vineyards on the limestone hillsides west of Paso Robles, Calif., and in the cool Santa Rita Hills northwest of Santa Barbara. It's part of the region between Los Angeles and San Francisco known as the Central Coast, which is emerging as a competitor to Napa and Sonoma. Here, vintners are creating fine wines with varietals from France's Rhône Valley. That's why they're known as Rhône Rangers. Here are some rangers you should get to know.

## Alban Vineyards

Founder John Alban was the region's pioneer, the first to plant Rhône varietals such as mourvèdre, grenache, roussanne, syrah, and viognier. People were skeptical that Alban could coax great wine grapes from this land, but he succeeded and became one of the region's top producers, making world-class wines that merit serious attention. [albanvineyards.com](http://albanvineyards.com); 805 546-0305

## L'Aventure

Bordeaux winemaker Stephan Asseo came here to tap the area's potential. He began producing fascinating wines from syrah and various blends of syrah and such Bordeaux varietals as cabernet sauvignon and petit verdot. [aventurewine.com](http://aventurewine.com); 805 227-1588

## Linne Calodo

Only in his early 30s, Matt Trevisan creates wonderful blends of such Rhône grapes as syrah, grenache, marsanne, roussanne, and viognier. These are brilliant, elegant, seductive, rich offerings. [linnecalodo.com](http://linnecalodo.com); 805 227-0797

## The Ojai Vineyard

A Central Coast old-timer, Adam Tolmach has been producing wine for over two decades. He continues to demonstrate a Midas touch with his various cuvées of syrah, viognier, and pinot noir from cool climate vineyards in the Santa Ynez Valley and Santa

Rita Hills. [ojaivineyard.com](http://ojaivineyard.com); 805 649-1674

## Sine Qua Non Winery

Austrian-born Manfred Krankl started this operation to ensure he had good wine to serve at his Los Angeles restaurant, Campanile. In a facility that looks like a *Mad Max* movie set, Krankl creates innovative blends of chardonnay,

roussanne, and viognier for the whites, and grenache, syrah, and mourvèdre for the reds. These world-class wines from a reclusive winery must be tasted to be believed. 805 640-0000

## Stolpmann Vineyards

After selling grapes from their 120-acre estate for many years, Stolpmann Vineyards hired top-notch winemaker, Sashi Moorman, who apprenticed under Adam Tolmach at Ojai Vineyard. The result has been a bevy of beautiful wines over recent vintages, including estate-bottled syrah and syrah-based blends. [stolpmannvineyards.com](http://stolpmannvineyards.com); 805 688-0400

## Tablas Creek Vineyard

This is a partnership between the Rhône Valley's hallowed Château Beaucastel and longtime importer Robert Haas. The early vintages were uneven and challenging, but Tablas Creek's wines are now coming into full glory, offering a remarkable array of complex whites and reds as varietals as well as blends. [tablascreek.com](http://tablascreek.com); 805 237-0000

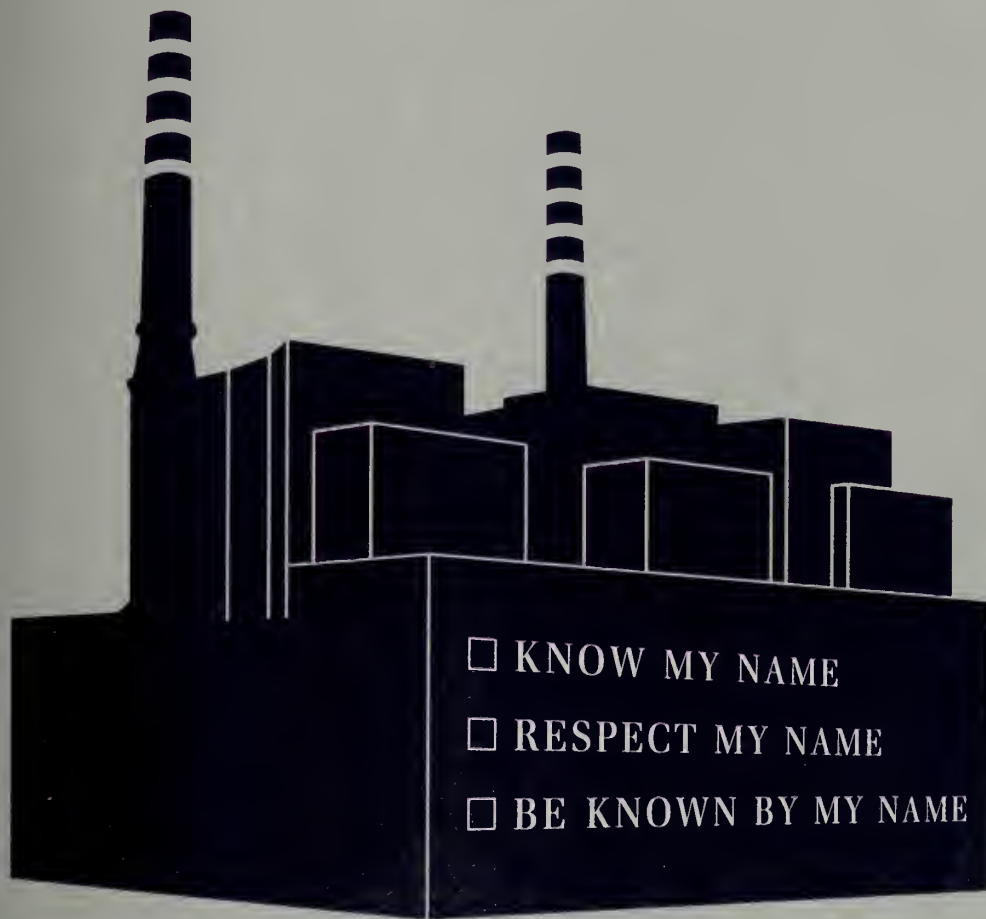
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## It's Gloomy in these Hedges

For retail investors, hedge funds of funds aren't paying off. **BY ANNE TERGESE**

**A** FEW YEARS BACK, everyone wanted to invest in hedge funds, but not everyone could meet these private partnerships' seven-figure minimum purchases. So Wall Street set up hedge funds for the merely affluent and registered them with the Securities & Exchange Commission, a move

that allows the funds to admit an unlimited number of investors and keep investment minimums in the \$25,000 to \$100,000 range. Since 2001 more than \$3 billion has been raised for these so-called funds of funds, which pool investors' dollars and spread them across a dozen or more hedge funds for diversification and to minimize the consequences of a fund blow-up.

How have these funds fared? In large, investors would have made money with a Standard & Poor's stock index fund (table). That's partly because the hedge fund investments investors with high fees—as much as a year. Moreover, with many managers engaging in rapid-fire trading, these investments can generate hefty bills. “Generally speaking, for a t

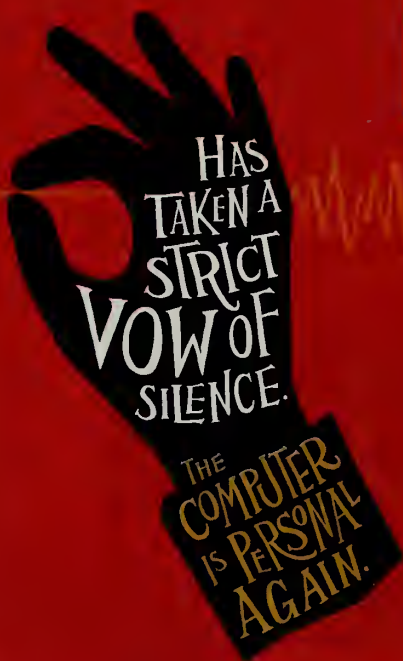
### Funds for the Merely Affluent

| FUND                                                  | SPONSOR                             | MINIMUM INV. | 2004 RETURN*      | 2005 RETURN*       | 2006 F |
|-------------------------------------------------------|-------------------------------------|--------------|-------------------|--------------------|--------|
| BACAP Alt. Multi-Strategy Fund                        | Banc Of America Investment Advisors | \$50,000     | 9.88%             | 2.59%              | 6.1    |
| Black Rock Multi-Strategy Hedge Opportunities         | Black Rock Advisors                 | 25,000       |                   | -0.21 <sup>1</sup> | 7.1    |
| BNY/Ivy Multi-Strategy Hedge Fund                     | BNY Investment Advisors             | 100,000      | 8.38              | 5.10               | 13.1   |
| Citigroup Alt. Inv. Multi-Adviser Hedge Fund G Shares | Citigroup Alternative Investments   | 25,000       | 10.39             | 1.43               | 11.1   |
| Citigroup Alt. Inv. Multi-Adviser Hedge Fund M Shares | Citigroup Alternative Investments   | 25,000       | 8.05              | 1.27               | 6.1    |
| Columbia Mgmt. Multi-Strategy Hedge Fund              | Banc of America Investment Advisors | 50,000       | 11.27             | 4.22               | 9.1    |
| Credit Suisse Alt. Capital Event Driven Fund          | Credit Suisse Alternative Capital   | 50,000       |                   |                    | 11.1   |
| Credit Suisse Alt. Capital Long/Short Equity Fund     | Credit Suisse Alternative Capital   | 50,000       |                   |                    | 17.0   |
| Credit Suisse Alt. Capital Multi-Strategy Fund        | Credit Suisse Alternative Capital   | 50,000       |                   |                    | 13.1   |
| Credit Suisse Alt. Capital Relative Value Fund        | Credit Suisse Alternative Capital   | 50,000       |                   |                    | 4.1    |
| Credit Suisse Alt. Capital Tactical Trading Fund      | Credit Suisse Alternative Capital   | 50,000       |                   |                    | 12.1   |
| DB Hedge Strategies Fund <sup>2</sup>                 | DB Investment Managers              | 50,000       | 9.69              | -0.48              | 4.1    |
| Excelsior Absolute Return Fund of Funds               | U.S. Trust Hedge Fund Management    | 100,000      | 4.85 <sup>3</sup> | 4.31               | 8.1    |
| Hatteras Multi-Strategy Fund I                        | Hatteras Investment Partners        | 100,000      |                   |                    | 10.1   |
| Hatteras Multi-Strategy TEI Fund                      | Hatteras Investment Partners        | 100,000      |                   |                    | 10.1   |
| JP Morgan Multi-Strategy Fund                         | JPMorgan Alternative Asset Mgmt.    | 50,000       |                   | 4.56 <sup>4</sup>  | 8.1    |
| Man-Glenwood Lexington                                | Glenwood Capital Investments        | 25,000       | 5.31              | 0.46               | 13.1   |
| Mercantile Absolute Return Fund                       | Mercantile Capital Advisors         | 75,000       | 9.13              | 5.27               | 7.1    |
| Mercantile Alt. Strategies Fund                       | Mercantile Capital Advisors         | 75,000       | 10.54             | 5.39               | 9.1    |
| Mercantile Long-Short Manager Fund                    | Mercantile Capital Advisors         | 75,000       | 13.35             | 3.91               | 17.1   |
| Mezzacappa Partners                                   | Mezzacappa Investors                | 100,000      |                   |                    | 10.1   |
| NT Alpha Strategies Fund                              | Northern Trust Global Advisors      | 100,000      |                   | 2.78 <sup>6</sup>  | 6.1    |
| Oppenheimer Tremont Market Neutral Fund               | OppenheimerFunds                    | 50,000       | 4.98              | 1.35               | 5.1    |
| Oppenheimer Tremont Opportunity Fund                  | OppenheimerFunds                    | 50,000       | 10.84             | 2.14               | 9.1    |
| SEI Opportunity Fund                                  | SEI Investments                     | 25,000       |                   | 5.06 <sup>7</sup>  | 8.1    |
| Topiary Fund for Benefit Plan Investors               | DB Investment Managers              | 25,000       |                   | 4.84 <sup>8</sup>  | 10.1   |
| Torrey International Strategy Partners                | Torrey Associates                   | 100,000      | 15.64             | 1.64               | 21.1   |
| Torrey U.S. Strategy Partners                         | Torrey Associates                   | 100,000      | 20.73             | 8.35               | 14.1   |
| AVERAGE                                               |                                     |              | 10.20             | 3.20               | 10.1   |
| STANDARD & POOR'S 500                                 |                                     |              | 35.12             | 6.69               | 11.1   |

\*Total pretax return measured for the 12-month periods ending Mar. 31 of each year: <sup>1</sup>Jan. 3, 2005-Mar. 31, 2005 <sup>2</sup>In liquidation <sup>3</sup>Dec. 1, 2003-Mar. 31, 2004 <sup>4</sup>Aug. 1, 2004 to Mar. 31, 2005 <sup>5</sup>July 1, 2005-Mar. 31, 2006 <sup>6</sup>Sept. 1, 2004-Mar. 31, 2005 <sup>7</sup>June 1, 2004-Mar. 31, 2005 <sup>8</sup>Oct. 1, 2004-Mar. 31, 2005  
Data: SEC filings, Hedge Fund Research

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investor, it's difficult to get any meaningful out-performance," says Nelson Lam, a fee-only registered investment adviser from Lake Oswego, Ore.

## ALL-WEATHER INVESTMENTS

ANOTHER REASON for their unimpressive numbers is that most of these funds aim for modest annual gains—ideally, in the high single digits—regardless of whether stocks rise or fall. The idea is that when stocks head south, such an "all-weather" investment preserves capital, leaving a bigger portfolio to work with when the good times resume. "Our fund is built for investors who want to diversify and protect themselves against down markets," says Greg Stahl, chief investment strategist at SEI Investments, sponsor of the SEI Opportunity Fund, which earned an average annual return of 7.11% from its inception in June, 2004, to June, 2006. "We're not for those with an aggressive risk profile."

Sizing up the performance of these funds is not easy. While most hedge funds are not required to publicly disclose their numbers, those that register with the SEC must—albeit only twice a year and sometimes with as much as a 90-day lag. That means reports for Sept. 30 may not be available until December.

A *BusinessWeek* analysis of performance data culled from SEC filings reveals that the average SEC-registered fund of funds with a minimum of \$25,000 to \$100,000 and a fiscal year that ends on Mar. 31—when the majority close their books—returned just 6% a year over the four years through Mar. 31. In contrast, the S&P rose an average of 7.2% a year during that period. The HFRI Fund of Funds Composite Index, composed of 850 hedge funds of funds with an average minimum of \$720,000, gained 7.9%. (Returns are net of fees, but not taxes).

Those investors who did best in these lower-minimum hedge funds are those who bought during the bear market. For the fiscal year that ended on Mar. 31, 2003, the few of these hedge funds around were about flat, while the S&P was down nearly 25%. Even so, an investor who put \$50,000 in the Oppenheimer Tremont Market Neutral Fund on its first day of operations, Jan. 2, 2002, would have amassed

\$57,872 by Mar. 31, 2006, vs. \$60,448 in an S&P 500 fund. Of the ten other SEC-registered funds of funds that date back to the bear market, eight show similar results: Assuming a purchase was made on the funds' launch dates and held through Mar. 31, the investor would have fared better with an S&P 500 fund.

For at least some of the SEC-registered funds of funds, the performance woes are likely to continue. SEC filings reveal that several had invested from 3% to 7% of their net assets in Amaranth Advisors, the Greenwich (Conn.) hedge fund that recently lost about 60% of its value on bad bets in the natural gas market. Among them: the Mercantile Absolute Return Fund, the BNY/Ivy Multi-Strategy Hedge Fund, the Credit Suisse Alternative Capital Multi-Strategy Fund, Deutsche Bank's Topiary Fund for Benefit Plan Investors, and the newly launched Morgan Stanley Alternative Investment Partners Absolute Return Fund. Brett Lane, manager of Mercantile's alternative investment business,

says with two dozen hedge funds portfolio, "it's premature for us to late on what the September performance is going to look like." Spokesmen for other funds declined to comment.

Of course, a prolonged and nascent market would turn the tables, let these sleepy funds overcome their performance deficits—and then, nonetheless, since the stock market tends to rise twice as often as it falls, investments "have got to do well in the way up, or they're just not going to be attractive" long-term proposition. Todd Trubey, an analyst at Morningstar.

The 40 mutual funds in Morningstar's "long-short" category, which use a mix of long and short fund strategies, have not fared well. The average annual return for the years ended Sept. 30 is just 6.1% vs.

## Mutual Funds that Hedge

These "long-short" mutual funds follow hedge-fund-like strategies, but have lower fees and are much more liquid.

| FUND                          | AVERAGE ANNUAL TOTAL RETURN |        |
|-------------------------------|-----------------------------|--------|
|                               | 1 YR.                       | 3 YRS. |
| Calamos Market Neutral Income | 6.9%                        | 4.0%   |
| Diamond Hill Long-Short       | 12.8                        | 18.3   |
| Gateway                       | 9.7                         | 7.3    |
| Hussman Strategic Growth      | 3.0                         | 6.6    |

\* Appreciation plus reinvestment of dividends and capital gains, before taxes. Through Sept. 30, 2006. Data: Morningstar Inc.



for all domestic stock funds you're interested in a hedge sort of play, you're better off with a mutual fund (table).

They allow investors to get performance information and liquidity on a daily basis. SEC-registered hedge funds of funds only offer periodic redemptions—quarterly arrangements are common.

The mutual funds generally cost less, too, with expenses that average 2.2%.

Still, investors have found cost-effective ways to diversify. Lam, for one, recommends buying real estate investment trusts, international small-cap stocks, commodities and plain old bonds—which don't always move in sync with stocks and bonds, which are available via cost index funds. By using hedge funds to the very end, the merely affluent can wind up wealthier on a long run. ■



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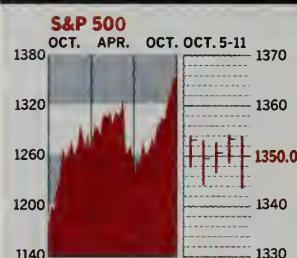
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## STOCKS



### COMMENTARY

Stocks pulled back at the end of the week as the new earnings season kicked off with Alcoa falling far short of Wall Street's expectations. Shares of the aluminum maker fell 5% on Oct. 11. Word that Phelps Dodge is being shopped around boosted the mining company's stock by 15.5% on the week. Energy, steel producers, and industrials turned in solid performances.

Data: Bloomberg Financial Markets, Reuters

## U.S. MARKETS

|                       | OCT. 11  | WEEK AGO | % CHANGE YEAR TO DATE | LAST 12 MONTHS |
|-----------------------|----------|----------|-----------------------|----------------|
| S&P 500               | 1350.0   | 0.0      | 8.1                   | 13.9           |
| Dow Jones Industrials | 11,852.1 | 0.0      | 10.6                  | 15.6           |
| NASDAQ Composite      | 2308.3   | 0.8      | 4.7                   | 12.0           |
| S&P MidCap 400        | 769.6    | 1.3      | 4.3                   | 12.5           |
| S&P SmallCap 600      | 379.2    | 1.1      | 8.1                   | 14.4           |
| DJ Wilshire 5000      | 13,484.9 | 0.3      | 7.9                   | 14.1           |

## SECTORS

|                      |       | WEEK AGO | % CHANGE YEAR TO DATE | LAST 12 MONTHS |
|----------------------|-------|----------|-----------------------|----------------|
| BusinessWeek 50*     | 762.9 | 0.1      | 2.8                   | 5.9            |
| BW Info Tech 100**   | 417.2 | 1.5      | 9.6                   | 16.3           |
| S&P/Citigroup Growth | 625.5 | -0.1     | 4.9                   | 10.0           |
| S&P/Citigroup Value  | 722.5 | 0.1      | 11.6                  | 18.1           |
| S&P Energy           | 401.5 | 0.4      | 7.7                   | 6.5            |
| S&P Financials       | 472.7 | -0.3     | 10.9                  | 22.3           |
| S&P REIT             | 187.4 | 0.2      | 22.4                  | 30.6           |
| S&P Transportation   | 262.3 | -0.2     | 5.0                   | 18.5           |
| S&P Utilities        | 174.9 | -0.1     | 9.5                   | 8.6            |
| GSTL Internet        | 178.6 | -0.6     | -13.0                 | 1.9            |
| PSE Technology       | 842.9 | 0.5      | 0.8                   | 7.9            |

\*Mar. 19, 1999=1000 \*\*Feb. 7, 2000=1000

## GLOBAL MARKETS

|                             | OCT. 11  | WEEK AGO | % CHANGE YEAR TO DATE |
|-----------------------------|----------|----------|-----------------------|
| S&P Euro Plus (U.S. Dollar) | 1805.9   | 0.6      | 19.1                  |
| London (FT-SE 100)          | 6073.5   | 1.8      | 8.1                   |
| Paris (CAC 40)              | 5313.2   | 1.1      | 12.1                  |
| Frankfurt (DAX)             | 6119.5   | 1.2      | 13.1                  |
| Tokyo (NIKKEI 225)          | 16,400.6 | 2.0      | 1.1                   |
| Hong Kong (Hang Seng)       | 17,862.8 | 1.3      | 20.1                  |
| Toronto (S&P/TSX Composite) | 11,619.1 | 0.0      | 3.1                   |
| Mexico City (IPC)           | 22,387.1 | 1.3      | 25.1                  |

## FUNDAMENTALS

|                                      | OCT. 10 | WEEK AGO |
|--------------------------------------|---------|----------|
| S&P 500 Dividend Yield               | 1.81%   | 1.83%    |
| S&P 500 P/E Ratio (Trailing 12 mos.) | 17.8    | 17.6     |
| S&P 500 P/E Ratio (Next 12 mos.)*    | 14.5    | 14.3     |
| First Call Earnings Surprise*        | 6.78%   | 9.41%    |

## TECHNICAL INDICATORS

|                                       | OCT. 10 | WEEK AGO |
|---------------------------------------|---------|----------|
| S&P 500 200-day average               | 1285.8  | 1283.6   |
| Stocks above 200-day average          | 61.0%   | 55.0%    |
| Options: Put/call ratio               | 0.82    | 0.95     |
| Insiders: Vickers NYSE Sell/buy ratio | 3.84    | 3.91     |

## BEST-PERFORMING GROUPS

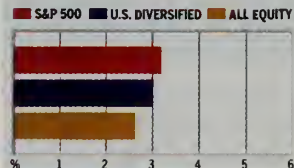
|                          | LAST MONTH % |                          | LAST 12 MONTHS % |
|--------------------------|--------------|--------------------------|------------------|
| Auto Parts & Equip.      | 17.2         | Steel                    | 97.1             |
| Casinos                  | 15.8         | Fertilizers & Ag. Chems. | 54.5             |
| Computer Stores          | 15.6         | Agricultural Products    | 52.7             |
| Real Estate Mgt. & Dvpt. | 15.2         | Department Stores        | 44.4             |
| Consumer Electronics     | 15.0         | Intgrd. Telecomms. Svcs. | 42.9             |

## WORST-PERFORMING GROUPS

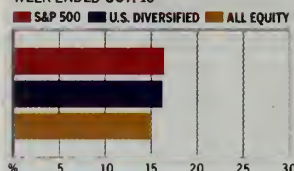
|                                | LAST MONTH % |                      | LAST 12 MONTHS % |
|--------------------------------|--------------|----------------------|------------------|
| Drug Chains                    | -13.9        | Internet Retailers   |                  |
| Health-Care Services           | -12.2        | Educational Services |                  |
| Gold Mining                    | -10.1        | Homebuilding         |                  |
| Tobacco                        | -5.1         | Internet Software    |                  |
| Health-Care Distribrs. & Svcs. | -5.0         | Gold Mining          |                  |

## MUTUAL FUNDS

### 4-WEEK TOTAL RETURN



### 52-WEEK TOTAL RETURN



Data: Standard & Poor's

## EQUITY FUND CATEGORIES

| 4-WEEK TOTAL RETURN      | %    | 52-WEEK TOTAL RETURN    | %    |
|--------------------------|------|-------------------------|------|
| <b>LEADERS</b>           |      | <b>LEADERS</b>          |      |
| Latin America            | 7.8  | Latin America           | 36.8 |
| Financial                | 4.1  | Real Estate             | 34.2 |
| Communications           | 3.7  | Precious Metals         | 30.7 |
| Small-cap Growth         | 3.3  | Diversified Emrg. Mkts. | 24.7 |
| <b>LAGGARDS</b>          |      | <b>LAGGARDS</b>         |      |
| Precious Metals          | -3.1 | Health                  | 8.6  |
| Japan                    | 0.1  | Natural Resources       | 9.0  |
| Natural Resources        | 0.7  | Large-cap Growth        | 10.0 |
| Diversified Pacific/Asia | 1.3  | Domestic Hybrid         | 10.1 |

## EQUITY FUNDS

| 4-WEEK TOTAL RETURN             | %     | 52-WEEK TOTAL RETURN        | %     |
|---------------------------------|-------|-----------------------------|-------|
| <b>LEADERS</b>                  |       | <b>LEADERS</b>              |       |
| DireXn. Lat. Am. Bull 2X Inv.   | 15.2  | Oberweis China Opport.      | 63.6  |
| iShares D.J. U.S. Bkr. Dirs.    | 11.8  | ING Russia A                | 53.4  |
| DireXn. NASDAQ 100 BL 2.5X Inv. | 11.5  | U.S. Global Invrs. Gold     | 52.0  |
| ProfDs. Mble. Tlcmms. Inv.      | 9.2   | Profunds. Real Est. Inv.    | 50.3  |
| <b>LAGGARDS</b>                 |       | <b>LAGGARDS</b>             |       |
| Ameritor Investment             | -50.0 | Ameritor Investment         | -90.0 |
| DireXn. NASDAQ 100 Bear 2.5X    | -10.5 | American Heritage Grth.     | -40.0 |
| Profunds UltSh. Emrg. Mkts.     | -8.7  | DireXn. Sm. Cap Bear 2.5X   | -31.8 |
| Profunds UltSh. OTC Inv.        | -8.5  | ProfDs. UltSh. Sm. Cap Inv. | -28.9 |

## INTEREST RATES

### KEY RATES

|                          | OCT. 11 | WEEK AGO |
|--------------------------|---------|----------|
| Money Market Funds       | 4.84%   | 4.85%    |
| 90-Day Treasury Bills    | 5.02    | 4.91     |
| 2-Year Treasury Notes    | 4.86    | 4.59     |
| 10-Year Treasury Notes   | 4.78    | 4.56     |
| 30-Year Treasury Bonds   | 4.91    | 4.72     |
| 30-Year Fixed Mortgage † | 6.18    | 6.12     |

## BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

|                       | 10-YR. BOND |
|-----------------------|-------------|
| General Obligations   | 3.83%       |
| Taxable Equivalent    | 5.47        |
| Insured Revenue Bonds | 3.88        |
| Taxable Equivalent    | 5.54        |

## THE WEEK AHEAD

### PRODUCER PRICE INDEX

Tuesday, Oct. 17, 8:30 a.m. EDT » Producer prices are forecast to have fallen 0.5% in September, after a 0.1% gain in August. That's the median forecast of economists polled by Action Economics. With energy and food excluded, producer prices most likely rose 0.2%, after a 0.4% dip.

### INDUSTRIAL PRODUCTION

Tuesday, Oct. 17, 9:15 a.m. EDT » September factory output

very likely increased by 0.2%, following a 0.1% dip in August. The factory utilization rate probably held steady at 82.4%.

### CONSUMER PRICE INDEX

Wednesday, Oct. 18, 8:30 a.m. EDT » September consumer prices for goods and services probably eased 0.2% on falling gasoline prices, after a 0.2% gain in August. Minus energy and food, the index most likely rose 0.2% for a third straight month.

### RESIDENTIAL CONSTRUCTION

Wednesday, Oct. 18, 8:30 a.m. EDT » September housing starts are expected to have fallen to an annual pace of 1.64 million. Starts were off 20% from a year ago in August, and housing permits plunged 22% in the same period.

**LEADING INDICATORS** Thursday, Oct. 19, 10 a.m. EDT » The Conference Board's leading economic indicators index likely rebounded 0.3% in September.

The BusinessWeek production index retreated to 284.3 for the week ended Sept. 30, but stood above the year-ago level. In calculation of the four-week average, the index fell to 283.1.

## BusinessWeek

For the BW50, more investment data, and the components of the production index visit [www.businessweek.com/extras](http://www.businessweek.com/extras)

# Six Stages to Better Records Management

Within just the past few years, thousands of new laws and regulations have been passed to eliminate lax and illegal corporate management practices. The laws serve a *vital* purpose, of course, but they also create significant new burdens on millions of companies.

Consider:

The corporate litigation load has so swelled that the typical \$1 billion company now must juggle an average of some 140 lawsuits at a time. The average Securities & Exchange Commission (SEC) fine against corporations has skyrocketed by 400% since 2000, climbing from \$1 million to \$5 million per incident. The Sarbanes-Oxley (SOX) was designed to strengthen accountability in publicly held firms, imposes an average annual compliance cost of nearly \$7 million, according to the Hackett Group, an Atlanta-based business consultancy.

## The Roadmap to Compliance

Deep as these costs are, there is both comfort and hope in the fact that all public and private companies face the same new requirements and that, by working together to develop a sound strategic response, firms can minimize the impact of many of them. The most powerful tool that companies possess in this regard is an effective "Compliant Records Management (CRM) Program"—that is, a program that efficiently manage corporate records and documentation. When an effective CRM program is in place, companies are better equipped to comply with the new regulatory requirements while operating their businesses with a minimum of disruption.



According to Iron Mountain Incorporated, the Boston, Massachusetts, based leader in compliant records management services, there are six critical stages in the roadmap to building a successful CRM program. The first stage is to analyze the program by carefully defining the program's purpose, scope, implementation, and administration, ensuring that these parameters precisely match the company's needs and resources. The second stage is to assess the state of

the company's current records program and to inventory the firm's physical and electronic records.

## The Best Defense

The third stage in the roadmap for an effective CRM program is to **develop** a well-organized and easily understood classification structure that gives authorized managers easy access to corporate records at all times. When companies are called upon to submit a document, merely having it in the company's possession is not enough; the company also must be able to produce it in a timely fashion. Similarly, companies need to assign retention periods for records based on legal, risk, and operational considerations, and to create a consistent disposition policy.

The fourth, fifth, and sixth stages all relate to the CRM program's ongoing operation. Specifically, the program must be **implemented**, typically in a carefully phased rollout that is accompanied by communication and training sufficient to build internal support. In addition, standard policies need to be implemented across media types, geographies, and business units. The program then needs to be **managed** on a continuing basis, and it must be systematically **audited** according to defined metrics in order to ensure its superior performance.

## A Good Offense

By practicing responsible records management, companies can minimize compliance costs and adverse legal consequences even amid today's strict regulatory regime. Accomplishing this goal won't be easy. But the best defense is a good offense, and an effective CRM program is the best offense available.

To learn more about creating a successful Compliant Records Management Program, please download Iron Mountain's white paper "The New Corporate Imperative" at [www.ironmountaincrm.com/bw](http://www.ironmountaincrm.com/bw)



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BY GENE G. MARCIAL

**A STEADY STREAM OF GROWTH IS COMING FROM HEINEKEN.**

**NU SKIN IS THRIVING AGAIN WITH DIRECT SELLING IN CHINA.**

**TAKEOVER TALK SWIRLS AROUND NEWALLIANCE BANKSHARES**

## Heineken Pours It On

**D**UTCH BREWER HEINEKEN (HINKY), the world's fourth-largest, is a global top brand. But its Big Board-traded American depository receipts are only now catching on with large investors. For one thing, the beermaker had three years of sluggish growth. But Heineken posted solid results in the first half of 2006. Its ADRs sprang from 16 in January to 24 in the summer and to 23 now. Charles Norton of Vice Fund, concentrated in alcohol, tobacco, and gambling stocks, says earnings for the second half and next year look good. So he thinks the ADRs will keep climbing. The Vice Fund in the three years ended Sept. 30 posted annual gains of 18.9%, vs. 12.3% for the Standard & Poor's 500-stock index. Many analysts are still "neutral" because of Heineken's rush upward. But Norton points to severe cost cutting, the introduction of Heineken Premium Light in the U.S., and expansion in Russia, where it has acquired nine breweries in two years. Now No. 3 in Russia, Heineken aims to boost its market share in five years from 14% to 20%. In the U.S., where it has just a 3.5% share, Heineken is betting big on a Premium Light version. The company has a deal with No. 1 Anheuser-Busch (page 96) to brew and sell Budweiser in Russia. Heineken already makes Bud for Anheuser in Italy and has teamed up with Mexico's Femsa to sell its Mexican beer in the U.S. Heineken is also making inroads in China and India. Nick Bevan of Deutsche Bank Securities rates Heineken a "buy" and expects earnings of \$2.47 a share in 2006 and \$2.79 in 2007 vs. 2005's \$1.01.



## Nu Skin's Blemish Is Clearing Up

**I**N JULY, 2005, WHEN CHINA BANNED direct-sellers from doing business there without a license, Nu Skin Enterprises (NUS) got clobbered: Sales of its skin-care and nutritional products, which had boomed for three years in China, plunged in just weeks from \$101 million to \$80 million. And its stock dived from 26 to 15. It has edged up to 18.14 since China issued Nu Skin a license on July 30, 2006. Rodney Hathaway of Heartland Advisors, which owns shares, bought in when the stock fell. He sees Nu Skin sales in China,

through its one-to-one contact with customers, ramping up again. He figures sales will hit \$500 million in three to five years. His 12-month target for the stock: 28. Douglas Lane of Avondale Partners expects the tide to turn as business speeds up again in China. He predicts earnings of 75¢ a share in 2006 on sales of \$1.10 billion and \$1 in 2007 on \$1.15 billion, down from \$1.04 on \$1.18 billion in 2005.



## NewAlliance May Lure a New Ally

**O**NLY THREE OF NINE ANALYSTS who track NewAlliance Bankshares (NAL), a Connecticut regional bank with \$7 billion in assets, are bullish. The rest worry that third-quarter earnings may disappoint the Street. So why is its stock popping—up from 13 in April to 15.17 on Oct. 11, near its 52-week high? Indeed, it is trading at more than 29 times its 2006 earnings estimate of 50¢ a share. The reason: takeover talk. Collyn Gilbert of investment firm Ryan Beck, which took the bank public in April, 2005, says investing in the stock provides a "decent defensive alternative" in the current market environment, "with the upside of being a potential takeover within the next 12 months." In the event of a buyout, she puts the value of NewAlliance at 18 to 20 a share. She believes the bank will repurchase shares to help establish a floor in the low 14 range. Given the "attractive risk-reward" she sees in the current price, she maintains her "outperform" rating. Gilbert forecasts earnings of 62¢ a share in 2007, vs. 2005's 50¢. Matthew Kelley of securities firm Sterne Agee & Leach Group, who rates NewAlliance a "hold," also says NewAlliance may get a boost from a takeover. He notes that with 5.8% of the bank deposits in Connecticut, NewAlliance is the fifth-largest in the state. ■



**BusinessWeek online** Gene Marcial's Inside Wall Street is posted at [businessweek.com/investor](http://businessweek.com/investor) at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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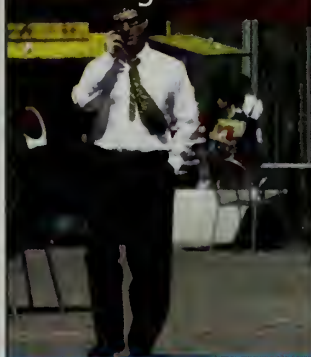
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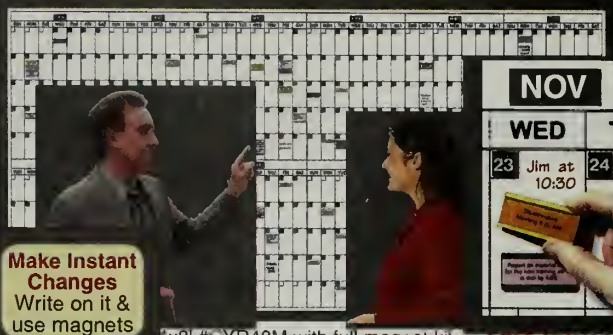
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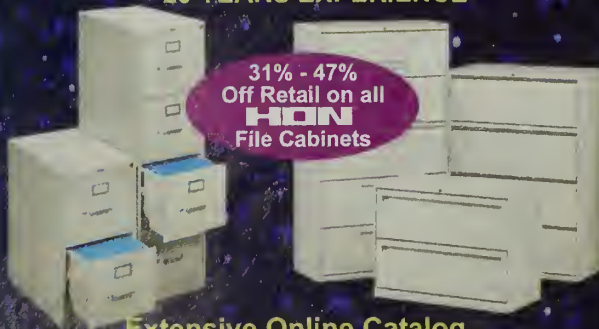
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## Sandy Weill's Wild Ride

**IN 1960**, Sandy Weill, then 27, and his partners opened a tiny brokerage on Wall Street. By 1981 he was president of American Express. Four years later he was ousted—on the pavement without a job. But in 1998, after taking an obscure firm, Commercial Credit, and building it into a behemoth, Weill was on top again as co-head of Citigroup. Now, in his just-published memoir, *The Real Deal*, Weill recounts his roller-coaster career and his often stormy relationships with some of the biggest names in finance: Arthur Levitt, James Robinson, Jamie Dimon, and others.

**You write about the protégés who learned so much from you....Let me ask you what you learned from them. What about Jamie Dimon [now CEO of JPMorgan Chase]?**

Jamie was incredibly smart and unbelievably loyal. He's a terrific partner who I really loved, and I hated to see our relationship...come to an end. Unfortunately, it had to. I had a great experience writing this book. It was cathartic. I decided it doesn't make sense to hold grudges forever.

**Tell me about your defeats.**

When I left American Express, everybody told me I'd get all kinds of offers. I didn't get all kinds of offers, but I went to work every day. My wife said: "Let's do this. Let's do that." I said: "I gotta go to work." And she said: "What do you mean go to work? You don't have a job." But I was afraid of missing a phone call, an opportunity. Finally, in the spring of '86, the Commercial Credit idea surfaced. No one really wanted it, but it was a chance to get started again, though in a different place....We were not part of this great city anymore. I remember the crash of '87. I had a terminal on my desk in Baltimore. This is not like Wall Street, where people jump out of windows because they're losing money in the market. Our customers don't know the market's down. There's no building that's higher than four stories [there], so they wouldn't be killed if they jumped.



**MELLOWER**  
Writing a book was "cathartic" for Weill

**What got you through that crisis?**

Two things. Number one, my family. My kids had the opportunity for the first time to see their father as a vulnerable rather than someone on top of the heap. I was someone who could help and relate to as a real person, so it enhanced my relationship with my children a lot. Also, I felt like I was writing my obituary before I was dead, and I was very nervous about people not staying friends with me because I was no longer president of AmEx, I no longer could do things for them. I offered to resign from the board of Carnegie Hall because I thought, how can I raise money if I can't help give other people money. But my friends really turned out to be my friends. It had nothing to do with me being part of AmEx. Some people will never ever find that out.

**Another point that you write about is the [Eliot] Spitzer scandal. Tell me about then versus now. How have things changed?**

The regulatory environment because of Sarbanes-Oxley has added expense. I think the lesson that came out of the early 2000s with all the investigations is the importance of reputational risk. It's just as important as market risk. What you're doing is on the front lines of a different environment. [Keeping your mind is] a good way to run your business.

**Are boards more independent today?**  
Boards are much more scared today.

**Tougher to get a director?**

It's a big issue, very tough to get a director.

**Because people are afraid of the liability?**

That's one reason. The other reason is directors are responsible for a lot of things [now], and it's close to a big-time job with [all that]. Most people have other things to do.

**Will you start a private-equity firm?**

I don't think so. I don't want to get into the rat race the best anymore. I've done a lot in 50 years in the for-profit world. I might need to do something to keep part of my brain busy, but it won't be anything that's full-time. It's more the part-time job to think about how to give my money away intelligently as I made it. ■

Maria Bartiromo is the anchor of CNBC's Closing Bell.



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# IdeasBooks

BY TOM PERKINS

## 'Wonder Woman with an MBA

**TOUGH CHOICES** A Memoir

By Carly Fiorina; Portfolio; 319pp; \$24.95

When Carly Fiorina parachuted into the corner office at Hewlett-Packard in July of 1999, the fabled "HP Way" was little more than a memory. Not much remained of the founders' entrepreneurial spirit. HP was dead in the water, divided into what Fiorina calls "a thousand tribes." The company was run by engineers who had

little marketing savvy: The joke of the day was that HP would sell sushi as "cold dead fish." In choosing Fiorina, the board sought to transform the place—and she sure did that!

Although more comfortable speaking at a Davos conference than writing for an engineering publication, and never very popular with the geeks in the technical departments, this Wonder Woman with an MBA had vision and strategy galore. She faced enormous problems. Breaking through the comfortable torpor of the corporate culture was a huge challenge. In the end, she laid the foundation for Mark Hurd, her successor, to lead HP to a position where it rivals IBM and has humbled Dell. The keystone to Fiorina's strategy was the acquisition of Compaq, the Texas outfit roughly the size of HP at the time. The merger was bitterly opposed by the family heirs of Dave Packard and Bill Hewlett, and only a leader of Fiorina's stamina and power of persuasion could have pulled it off.

However, though excellent at the "vision thing," Fiorina created an organizational matrix so complex that only she seemed to understand it—but maybe that was the point. Perhaps the worst disappointment of her tenure was the resignation of Michael Capellas, the former CEO of Compaq, who left only a few months after the merger. The intention was to have him serve as "Mr. Inside" running the business, while Fiorina wowed customers and Wall Street as "Ms. Outside." Fiorina's failure to find another Capellas and to delegate significant operational responsibility prompted the board eventually to dump her. HP stock rose 7% on the announcement of her departure.

Fiorina recounts all of this history in her just-published book, *Tough Choices: A Memoir*. It is a very engaging read. If Horatio Alger had written a gender-correct sequel to *Tom the Bootblack*, this is what you might expect. Admittedly, she gives little space to such personal matters as the divorce from her first husband and her huge compensation and severance packages, which triggered bad publicity and even a

shareholder class action. But many readers will identify Fiorina as she describes her rise from a solid middle-class background and her life as a loving and dutiful daughter. Her brilliance as a student is evident, and we discover that she has an innate flair for marketing. Chapters dealing with her meteoric rise through Lucent are excellent: Women will find them particularly interesting as she lays to rest the myth of the glass ceiling. Along the way we meet her second husband, Frank, an executive in his own right who sidetracked his own career to become a rock-solid foundation for hers. The book makes it clear that they have a most and successful relationship.

Not unexpectedly, half of *Tough Choices* is about Fiorina with HP, and it will surely be a must-read for employees and friends of the company. At HP, Fiorina here seems to pay more attention to inspirational words than to the numbers. The volume is freighted with sentences like "I deeply believe that every person has more potential than they realize." Still, the volume is a vindication of her performance, though the numbers that HP is currently achieving provide a vindication enough.

There are some errors in fact—Dave Packard returned from his stint as Deputy Defense Secretary in late 1971 not 1990,

for example. But Fiorina carefully documents her struggle with the HP board. She is, rightly, outraged over the leaks to the press that so complicated her relationship. Such disclosures can be very damaging and are certainly indicative of deep divisions at the top. Overall, in my view, she fails to understand the board's frustration over HP's deteriorating performance.

and her style of management. Probably not enough time elapsed for the book to be called *Lessons* rather than *Choices*.

Fiorina says some unpleasant things about me. She is downright nasty toward her successor as HP chairman Patricia Dunn, who also has aimed some criticism in my direction in recent weeks. Maybe they are both right. I probably am too easily bored with board process, and too preoccupied with customers, growth, market share, and the bottom line. It is my own interpretation of the HP Way.

Perkins is a Silicon Valley venture capitalist, a former HP member, and the author of a satirical novel, *Sex and the Zillionaire*.



**If only she had found a "Mr. Inside" to match her "Ms. Outside"**

# Fiorina on Leaks and Her Legacy

**Did you first trigger the investigation into the boardroom leaks at HP?**

What I did when faced with a very damaging leak was to call a board meeting. I dealt with the issue directly with each of my board members. To me the leak was...a symptom of something bigger: dysfunction.

**You didn't say: "We need to hire outside investigators"?**

Absolutely not. I wasn't going to have someone run around behind the scenes trying to figure out what's going on in our board room. This was something for us to solve. Board member to board member. Figure out how to move forward in a productive way. That's what corporate governance is about.

**Is there anything that you can look back at and say: "If I hadn't done this, things would have gone differently"?**

Well, yes. I had great misgivings about Tom Perkins coming back on the board [in 2005 after retiring in January, 2004], and I wish I'd've listened to those misgivings. That was a mistake.

**Why?**  
Because he became disruptive. And because there was a mandatory retirement age, and we broke our own rules. Rules are there for a reason.

**Do you think Tom Perkins had integrity?**

I think anyone who cannot look someone in the eye and discuss face-to-face a tough issue in a respectful, honest way lacks integrity. If you are in a boardroom, the mailroom, or around the kitchen table, you have to be able to deal with tough issues...with perspective and, hopefully, empathy. You have to speak the truth to one another. And when people can't do that, dysfunction occurs...and bad things happen. And when people say things behind someone's back instead of to their face, yes, I think they lack integrity.

**It seemed as though the board stuck by you for a long time, then the end was fast and furious.**

The board and I did stick together. Every single decision made on my watch was a unanimous vote of the board. It was fast and furious in the end because the decision the board made was not about performance, it was not about whether we were aligned on strategy or execution. I think it was about the reality that I wasn't going to condone certain behavior and I wasn't going to cut corners on corporate governance.

**Do you think the success of the company since you've been gone is a reflection of what you put in place?**

Yes, [but] not completely. I'm certainly not sitting here saying that I deserve 100% of the credit for what's happened in the 18 months since I've been gone. But I deserve my fair share. The reality is...I transformed the business...when the economy was suffering greatly. The success the company enjoys today is because of the merger with Compaq...and the heavy lifting to turn HP into a meritocracy, a customer-focused organization, and a powerhouse innovator.

**Some people feel that if you had been speaking less and not been on so many magazine covers, perhaps you would have been running the business better.**

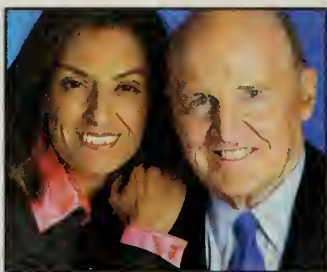
One of the hardest decisions I had to make about writing this book was whether I wanted to go out into the public eye again. I don't enjoy it. People have this image that somehow I just loved all that. That was the most difficult part of my job. Did HP benefit from the fact that I was visible? Yes. HP was viewed as a sleepy company falling further and further behind.... It became, in the course of my tenure, a well-known, well-regarded, hip company.

**When you were fired, what gave you the will to come back?**

I'm not going to deny that it was a tough blow and a tough couple of days and weeks, but I also don't want to convey that I fell apart and hid in a hole. I know who I am. I know what I accomplished. I know that I made a positive contribution. I know I conducted myself with honor and integrity. ■







# Ideas **The Welch Way**

BY JACK AND SUZY WELCH

## The Six Sins of M&A

**What is the right cycle time for mergers and acquisitions? How do you prepare for integration? What would you do in the first 30 days after closing?**

—Bernhard Klingler, Linz, Austria

In other words, how do you not screw up M&A? Good question! Because while organic growth gets better press, and it is certainly less fraught with blood, sweat, and tears—not to mention risk—M&A remains the fastest, most powerful tool a company can use to change its competitive game.

As your letter suggests, there's no rulebook for M&A. Fifty years into intense worldwide M&A activity, with thousands of examples to learn from, companies still botch it, too often not realizing the anticipated benefits of a deal. On top of that, many people who live through the "A" part of the process will tell you the whole thing felt a little like a death to them, with their lives turned upside down. Still, no company should shy away from M&A, and it doesn't sound like you plan to. Here, then, is our list of the six most common pitfalls of M&A:

First, beware any "merger of equals." The idea is noble, the reality a mess. The reason is in the premise. If the merging companies are so darned equal, why should either adopt the practices, policies, or people of the other? Mergers of equals routinely come undone over that question as teams spend months dueling over who's in charge.

Second, recognize that the cultural fit of two companies is as important as strategic fit—if not more so. Oh, how exciting it seems when a merger or acquisition makes perfect sense in terms of products, technologies, and numbers. But what a disaster it can and will be if the two companies operate with distinctly different values. The fact is some cultures don't combine—they combust.

Third, run for the hills if you find yourself entering a "reverse hostage" situation. Sometimes an acquirer wants a company so badly it starts making concessions, and by the time negotiations are over, the acquired company is virtually in charge. Don't get yourself in a position where you're wondering: "Why did I pay so much for something I don't really own?"

Fourth, to quote the angel Gabriel: "Be not afraid."

**M&A can turbocharge your growth—if "deal heat" and its friends don't get in the way**

When it comes to integration, boldness is the most sensible approach. Ideally, the integration process should be complete at the time of the closing and certainly within 90 days. Otherwise, uncertainty can morph into inertia, or worse. Both cripple morale—and operations.

Fifth, don't fall into "conqueror syndrome" by marching into your new "territory" and installing your people everywhere. Look, one of the main reasons you do M&A is to get twice the talent to pick from. Of course, acquirees are loyal to colleagues, but for the new and expanded company to thrive, it needs the best team, even if that means letting some of your own go.

Sixth, don't pay too much. We're not talking about a 5% premium; that will be lost in the rounding if the deal works. We mean 20% or 30%, which happens often. The culprit is "deal heat"—the negotiating fire fanned by competing bidders and investment bank pressure. Remember, there is no last best deal, only overheated desire that makes it feel that way.

Now, we realize that six traps are a lot to avoid, especially in the turbulence before any deal. But if you fall into one or two along the way, acknowledge your mistake, and climb back out. Organic is great, but M&A can add real firepower to your growth arsenal.

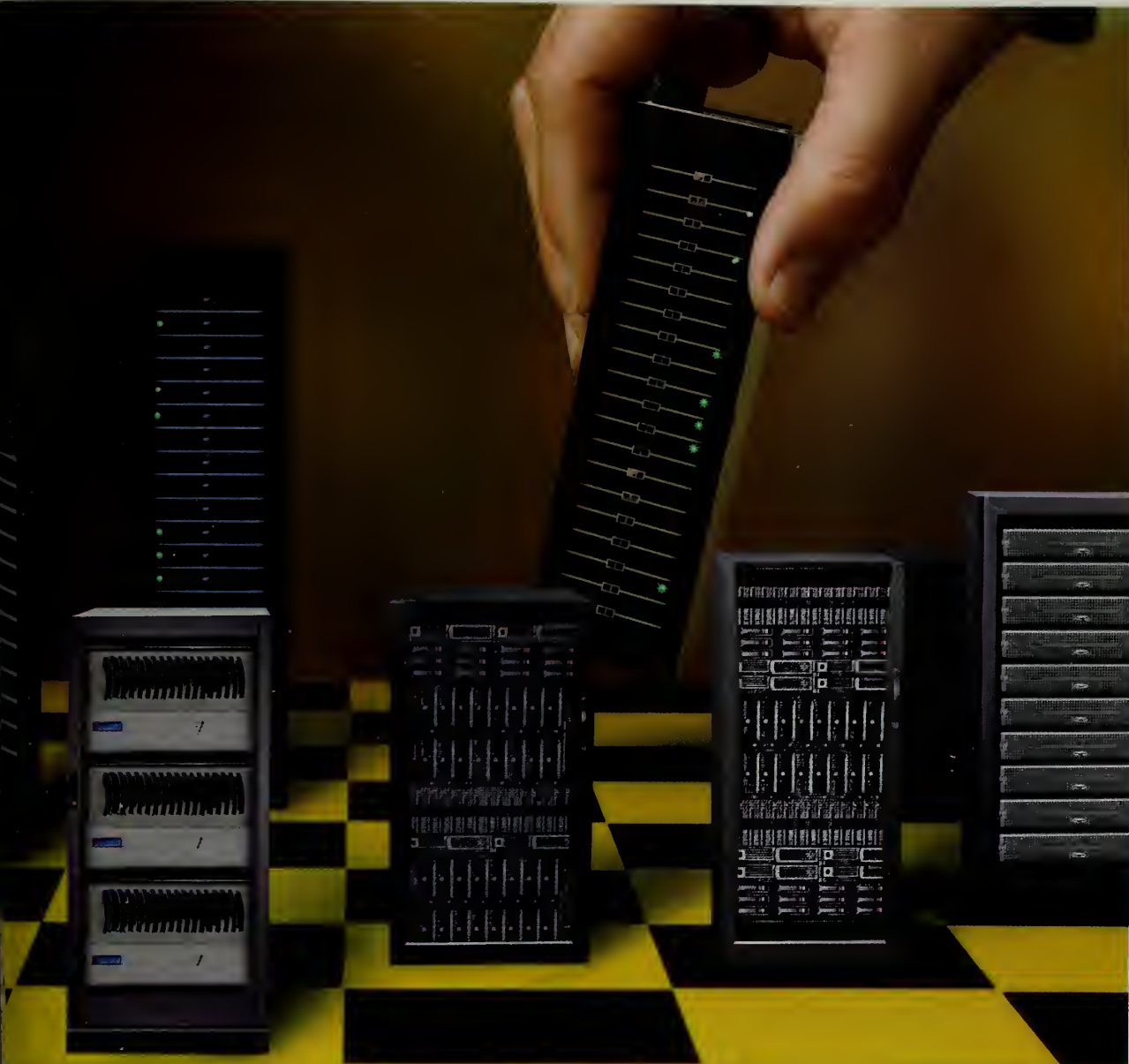
**I really believe in my company's product and respect my co-workers and bosses. But I'm overwhelmed by the ever-increasing demands of work and my young family. Part of me wants to find a new job, but maybe that's shortsighted. Your advice?**

—Anonymous, \*

Stay! You've got a good thing going. How often does someone say he really likes the "big three" of work: company, product, and people? But we hear you about burnout. That's a problem in any high-powered job and a dynamic certainly exacerbates conflicting demands. A person just can't give 100% everything and everybody at the same time.

So you'll need to make a trade-off. Maybe it will be working someplace less draining. Maybe it will be spending less time with your family. But don't decide until you've tried every strategy to make your balancing act more livable. In your condition, the last thing you need is the additional stress of knowing you left a good thing behind. Give work a chance. ■■

*Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at [thewelchway@businessweek.com](mailto:thewelchway@businessweek.com). For their weekly podcast, go to [www.businessweek.com/search/podcasting.h](http://www.businessweek.com/search/podcasting.h)*



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A man in a white shirt and dark pants is crouched on a rocky shore, looking out at a lighthouse. The lighthouse is white with a black top and is situated on a rocky island. The sea is dark and stormy, with white-capped waves crashing against the rocks. The sky is filled with dark, heavy clouds, and a bright light source, possibly the sun or moon, is visible through the clouds, creating a dramatic, high-contrast scene.

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# Gluttons At The Gate

**HOW PRIVATE EQUITY**  
is using slick new  
tricks to gorge on  
corporate assets

BY EMILY THORNTON (P. 58)

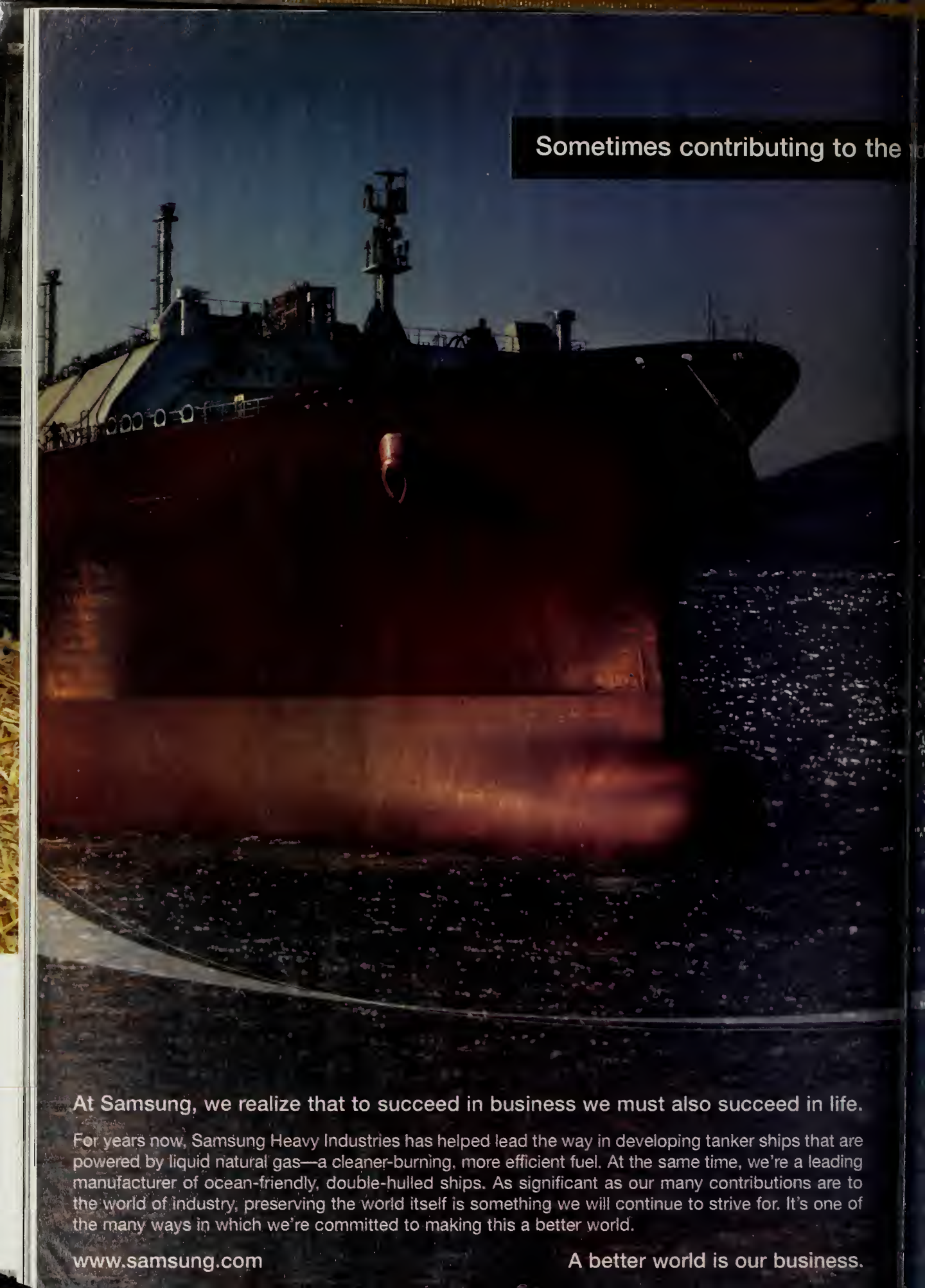


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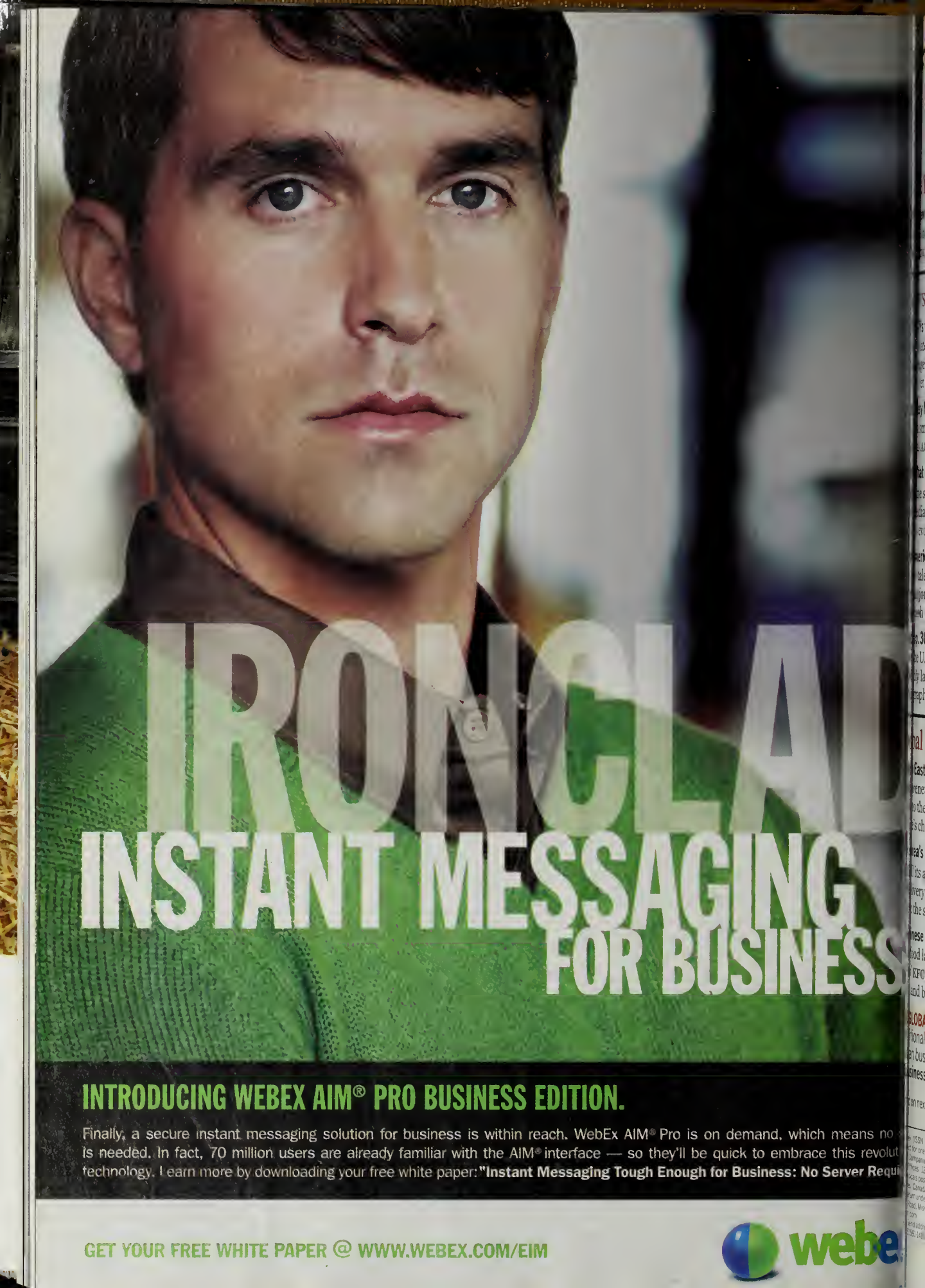
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# BusinessWeek

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on the options scandal; Wal-Mart  
na; a fatter trade gap; and more

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# What's Hot This Week At **BusinessWeek.com**

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## Coping with Caring

With Americans living longer, planning for the care of elderly parents has become a pressing issue. This is especially true for people in the so-called Sandwich Generation, who find themselves responsible for caring for children, as well. The financial and emotional strains can be enormous. In our *BusinessWeek.com* special report, *Preparing for Aging Parents*, we offer ways to help, from advice on **getting your parents' financial house in order** to investigating **long-term care insurance** to **avoiding the financial squeeze**



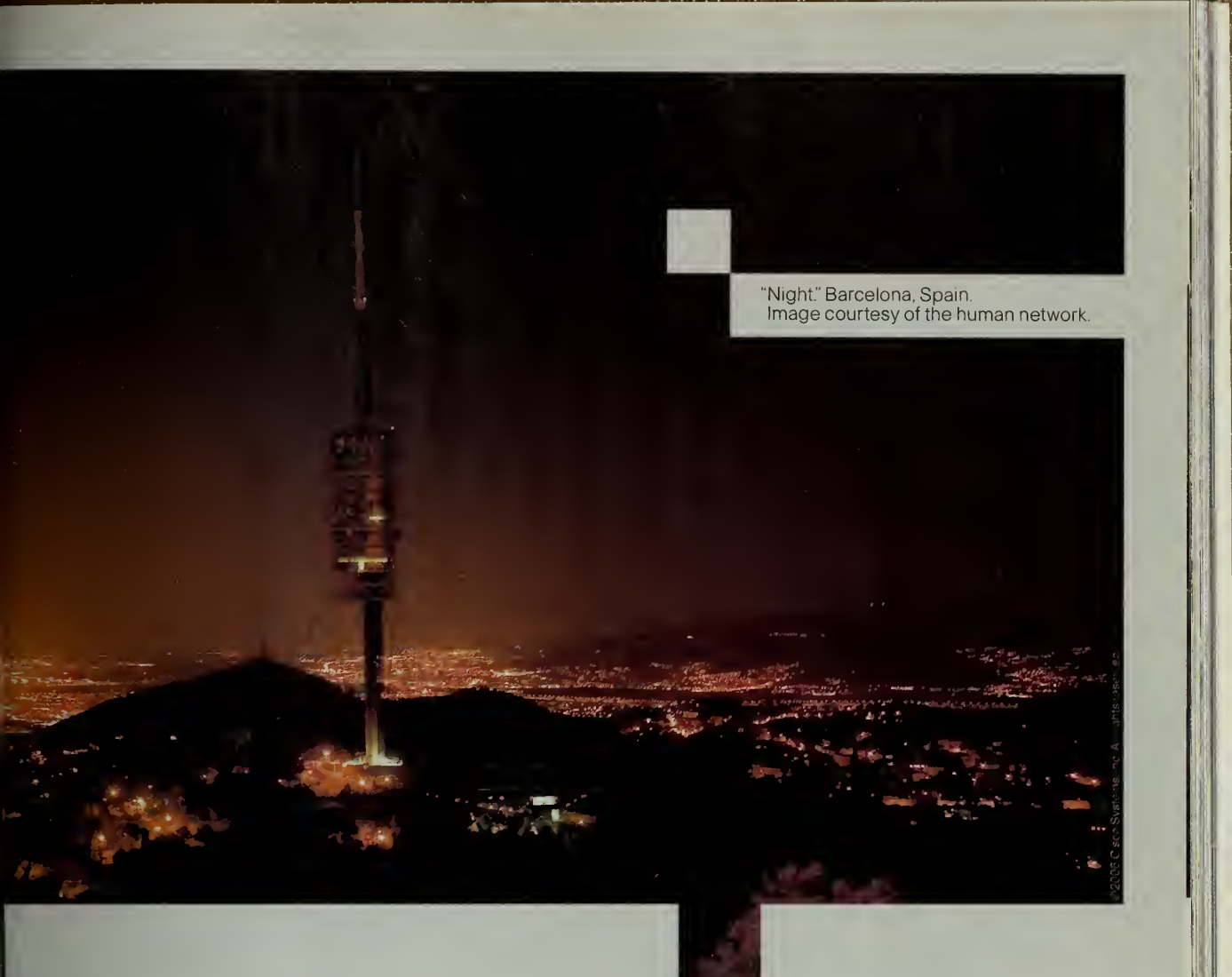
of eldercare. And with choices on the types of facilities more numerous and complex than ever, we'll help you sort through the array of eldercare options. The report also features useful tips on **protecting the elderly from financial abuse** and **making eldercare less stressful** for siblings and parents. Since technology plays an increasingly large role in people's lives, our featured slide show profiles **gadgets that help keep an eye on seniors**. Dealing with the ups and downs of old age can be challenging. But with a little savvy and careful preparation—the burden doesn't have to be so heavy. For this and more, go to [www.businessweek.com/go/06eldercare](http://www.businessweek.com/go/06eldercare)

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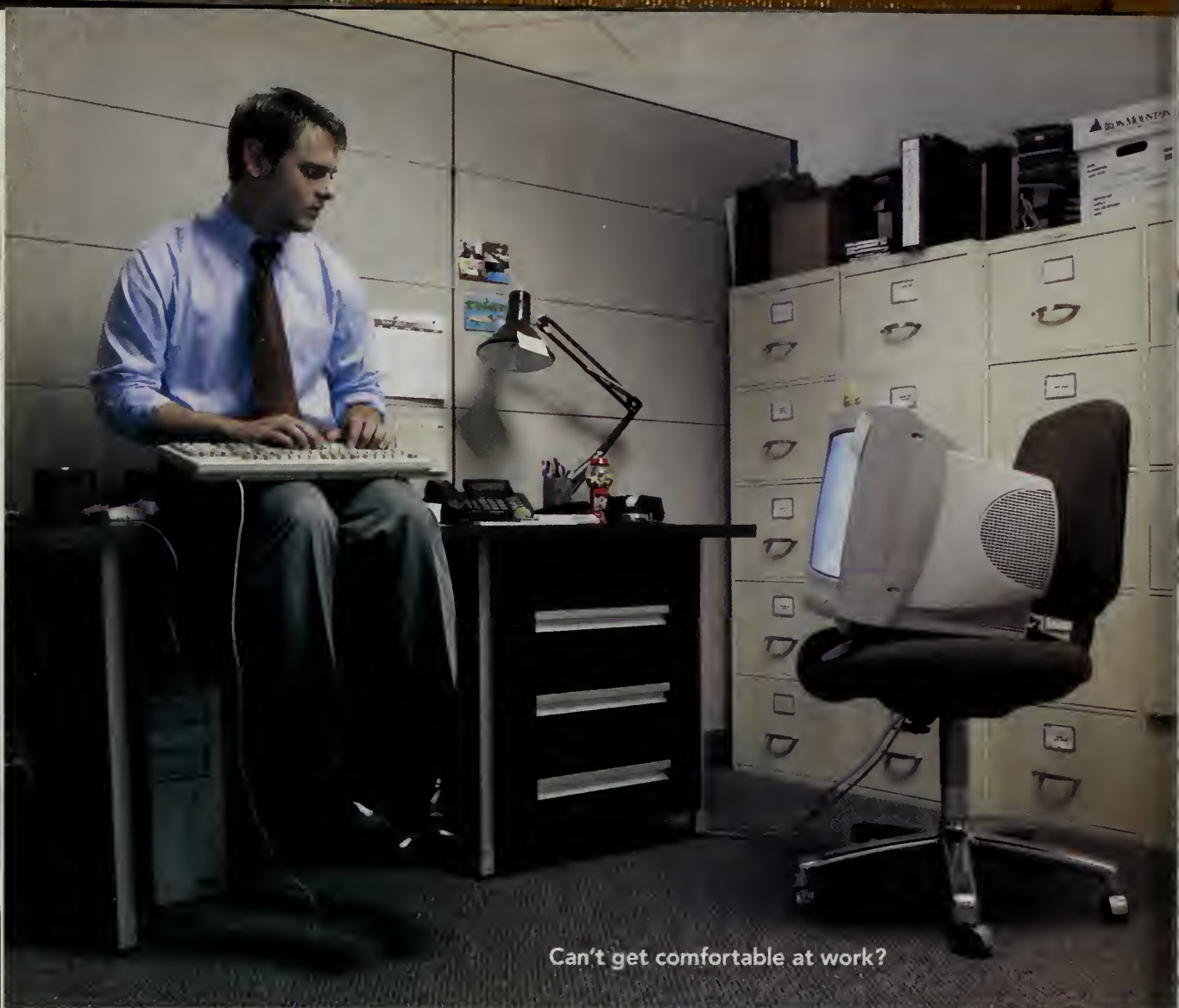
"Night." Barcelona, Spain.  
Image courtesy of the human network.

the human network, the whole world is a lab.  
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# JP Front

**"What'd they use to call Chicago—the hog butcher of the world? We are now the risk managers of the world."**

—Retired Chicago Mercantile Exchange Chairman Jack Sandner on the Merc's planned purchase of the Chicago Board of Trade for \$8 billion, as reported in the Chicago Sun-Times

BY DEBORAH STEAD

## D CITY CLOCK IS TICKING ON STREAK

The Street's longest streak looks as if it's no end. Bill Miller, Legg Mason Value Mutual fund has beaten the return of the S&P's 500-index for a 15 calendar years nearly twice as long as his nearest trailing competitor this year. Miller finished by 12.1 percent in the third quarter's performance the S&P had racked up a 5.5% return of price and dividends against a 3.6% loss, according to analysts at Lipper. Miller has not been this good since 1987, though

Miller did overcome gaps of 3% and 4% in 2005 and 2004, respectively. His biggest losses seem to have come from holding Amazon.com, Yahoo!, and eBay, all down more than 30%. He's also been hurt by the troubled Sprint Nextel merger, UnitedHealth's option scandal, and homebuilders' weak results. Adding insult, one of the few stocks he's



MILLER

apparently sold, Intuit, is up 33%.

Miller has long warned investors that his streak will end someday. Early this year he noted that calendar years are the only 12-month

periods in which his results always beat the S&P. Besides, says Mary Chris Gay, his assistant portfolio manager, he picks stocks for their three- to five-year returns. Give the market time, she says, and it should see prices his way. —David Henry



DAY IN COURT  
Skilling (left)  
and Petrocelli  
early in the  
Enron trial

## PAY CHECK

# One of Them Is Still Laughing

**THE LEGAL TAB** for defending Enron CEO Jeffrey Skilling, who is due to be sentenced in federal court in Houston on Oct. 23, is shaping up to be one of the priciest in criminal defense history. Before his indictment, Skilling put \$23 million into a trust for legal fees. His lawyer, Daniel Petrocelli, got that, along with \$17 million from the insurers that provided Enron with directors' and officers' liability coverage. And Petrocelli says in court filings that his Los Angeles-based firm, O'Melveny & Myers, is owed \$30 million more, bringing the grand total to \$70 million, an amount that astonishes other attorneys. "It's magnificent, it's shocking, I'm jealous," says Philip Hilder, who represents Enron whistleblower Sherron Watkins. Quips Enron shareholder attorney Bill Lerach: "What would he have been paid if he had won?"

Petrocelli justifies the expense. Skilling's criminal case, he says, took a team of 12 lawyers, 5 paralegals, and temporary staffers, many of whom had to be housed in Houston for months. He billed his own services at nearly \$800 an hour. Some expert witnesses made \$600 an hour. A dozen staffers were devoted just to paperwork, including over a billion pages of documents. Petrocelli also points out that he's represented Skilling for a total of five years, in appearances before Congress and the Securities & Exchange Commission and in several civil suits. A case like Skilling's, Petrocelli says, "requires a small infrastructure of its own to litigate." —Christopher Palmeri

## BIG PICTURE

**GE** annual CEO pay is \$11 million, 369 times the worker pay of \$30,000. In 1970, before the pay explosion, the multiple was 10. The ratio that would equal today's average CEO pay is \$374,800. Put it this way: If CEO pay were frozen now, it would take workers 66 years of 4% raises to get back to what the boss gets.

—David Henry



Source: University of Southern California; CEO pay rounded up; based on S&P 500 companies. Source: Bureau of Labor Statistics; ratios rounded to nearest whole number.



# UPFront

## PRISONS

### INMATE ED— WITH A BUS TICKET

**SOME MEXICAN** citizens convicted of a crime in the U.S. are getting something beyond hard time and deportation: homework. **Corrections Corp. of America** has been running schools for

were started by the prison corporation in 2003, the Mexican government has expanded the program, which is conducted in Spanish, to 29 other public and private prisons.

Mexican officials don't have statistics on how many graduates avoid criminal pursuits or find jobs back home after graduation. But, says Juan Solana, Mexican consul in Albuquerque, N.M., most Mexican immigrants say they would prefer to stay home, despite the high numbers who come into the U.S. illegally. Says graduate Francisco Sanz, 34, who will be deported next spring after doing time for acting as a drug courier: "When you have a job, you don't want to come back." Solana says more Mexican prisoners in the U.S. finish the program than U.S.-based Mexican civilians studying the same courses in community centers. "These people have a lot of time," he says.

—Brian Grow



**GRAD** With skills for work back in Mexico

the 5,000-plus Mexican nationals incarcerated at its private prisons in California, Colorado, New Mexico, Oklahoma, and Texas.

The aim: getting inmates to stay in Mexico once they're released and deported. The curriculum, says Dennis Bradby, CCA's vice-president for inmate programs, is one way to inject skilled workers into Mexico. "Therefore, there will not be a need [for the former inmates] to come back to this country," he says.

The Mexican government provides books, computers, and curriculum guidance for the classes—in math, reading, writing, and trade skills. (The course follows the requirements of Mexico's public education system.)

Running the program costs CCA about \$230,000 a year for in-house teachers and inmate tutors. Some 3,700 Mexican inmates have graduated from the CCA elementary, junior high, and general equivalency diploma programs, including 500 in September. Since the classes

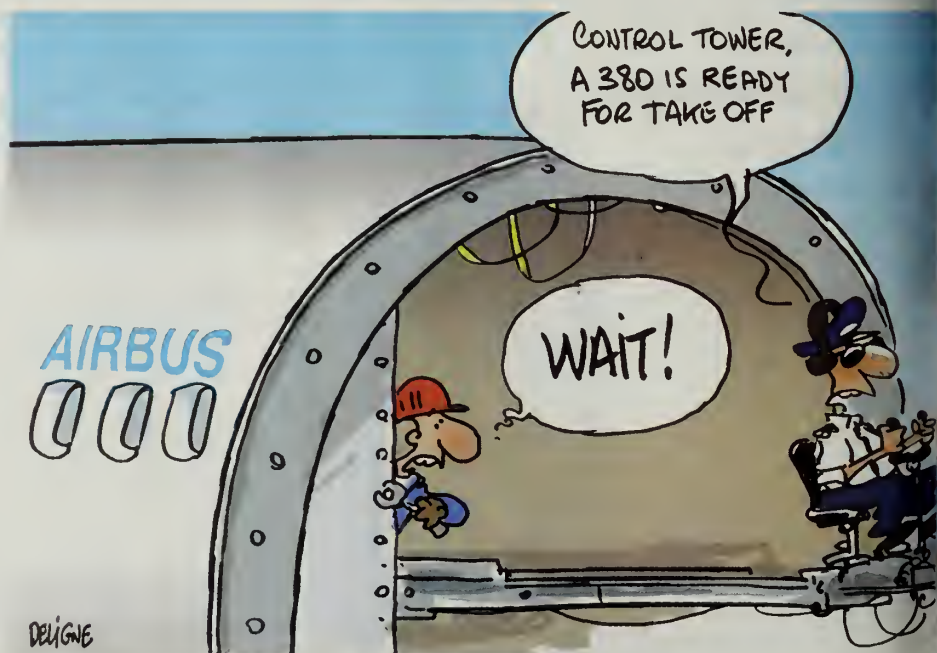


## WIGGLE ROOMS

**THE FOUR-MAN BAND** from Down Under that is wildly popular with the four-and-under set, the Wiggles (above, with sidekick Captain Feathersword), already has a TV show that airs twice daily in the U.S. on the Disney Channel as well as brisk video and DVD sales. Now the group is wiggling its way into more of the American market. On Oct. 17 the first Wiggly Play Center opened in a Dallas suburb.

The nutrition-minded band plans to franchise these romper rooms, which feature party facilities and a healthy food café.

"Everything is baked, not fried," says Anthony Field, aka the Blue Wiggle. —Lauren York



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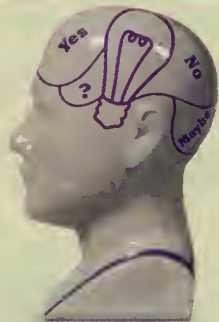
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## GRAY MATTERS



### THE POWER OF AMBIVALENT THINKING

Positive thinking may not always be a plus. According to a study by **University of Washington B-school** assistant professor Christina Ting Fong, ambivalent feelings—the simultaneous anxiety and excitement of starting a new job, say—may result in enhanced creativity. Fong divided about 100 students into four groups to write about life events that made them feel either happy, sad, neutral, or ambivalent. (Another test later assessed whether participants in each group felt the desired emotion.) The students then took the Remote Associates Test, a commonly used measure of creativity. Those who felt ambivalent came out on top. Complex emotions, theorizes Fong, may lead to complex thinking.

What's the link? **MIT** neuroscience professor John Gabrieli explains it this way: Problem solving requires access to all our mental resources, and an ambivalent state broadens thinking, perhaps allowing us "to cast a wider net" over the information in our brains. —Lindsey Gerdes

## FLAMED

### HOLD THE PICKLE, EXTRA LITIGATION

**BURGER KING** has been flame-broiling Whoppers since 1957. But if Whitney Leeman has it her way, the chain will have to post notices in California that its Triple Whoppers contain excessive levels of a suspected carcinogen. She'd also like a side of civil penalties with that.

Leeman, an environmental engineer from Sacramento, has sued dozens of companies under Proposition 65, a 1986 law requiring that vendors disclose ingredients the state has identified as having links to cancer or birth defects. Companies that don't tell can be sued, and under Prop 65 anyone can be a plaintiff.

In April, after Leeman found companies selling soda in bottles labeled with lead-based paint, authorities in the state

won \$2.25 million from **PepsiCo**. In July, she sued Burger King and **CKE Restaurants**, parent of Carl's Jr., for not warning of polycyclic aromatic hydrocarbons in flame-broiled meats.

What makes Leeman sue? Money, say some defendants. Her suits have brought three dozen settlements totaling \$11.4 million in fines. Prop 65 lets plaintiffs get up to 25% of the penalties. Her take comes to \$385,550, says Clifford Chanler, a partner at law firm **Hirst & Chanler** who regularly represents Leeman. Charles Seigel, general counsel at Carl's Jr., calls her a "bounty hunter" whose "modus ope-



LEEMAN

randi is to make unfounded allegations, try to collect a quick settlement, and win." Seigel says the company will prove in court that its burgers are safe. Burger King declined to comment.

Leeman, 39, with a PhD in dioxin research, says she wants to protect consumers and that her portion of penalties comes to \$64,000 year before expenses—sufficient research to prove the presence of harmful compounds. She works, rents a tiny house, and drives a Subaru. "I am not a rich person," she says, adding that companies she has sued

agreed to use safer ingredients.

Edward G. Weisbach, a California supervising deputy attorney general, calls Leeman one of the most prolific litigators of the 2000s, but thinks she's sincere. "She is not emptying the building," he says. —Michael



## PAPER OR PLASTIC?

### A MARRIAGE OF CONVEYANCE

**ADS ARE MOVING** into what may be the last commercial-free space at the supermarket: the checkout conveyor belt. **EnVision**, a Little Rock marketing company, prints ads on custom-made plastic belts and has placed them in several southern chains, including Harps Food

Stores in Arkansas.

Frank Cox, **enVision's** CEO, sees the checkout conveyor as "real estate that wasn't used effectively before." Cox is in preliminary talks with stores in other U.S. regions, as well as in Canada and Mexico. He is trying to broaden the ad mix—which currently ranges

from local banks and hospitals to mobile providers like **Alltel**—to include snacks, magazines, both common impulse buys at the counter.

Supermarkets get a percentage of the ad revenue or a flat "rental" fee. And cleaner counters: **EnVision** does biweekly conveyor upkeep and plans to install new ad-laden belts every three months.

—Elizabeth W.



## CHECK IN AT DALLAS WHILE YOU'RE STILL IN CHICAGO.

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# UP Front



## THE MESSAGE

### WHERE THE RUBBER MEETS THE ABODE

**IT'S ALMOST** as if GM and Nissan had joined up after all. The two auto giants are running startlingly similar ad campaigns this month. Targeting young buyers, both aim to show that their less-expensive models—a 2007 Chevy Aveo in GM's case, a 2007 Sentra in Nissan's—are roomy enough to live in. At least for a week.

Chevrolet's "Livin' Large" campaign, run by its in-house communications people and slated to launch on Oct. 23, will feature two-person teams at eight colleges, from Boston University to the University of Southern California.

» **THE BRANDS** Chevy Aveo, Nissan Sentra (above) » **THE CAMPAIGNS** Low-cost cars so roomy you can live in them » **THE VERDICT** Could resonate with cash-strapped young buyers

Instead of a dorm room or apartment, each duo (selected from about 400 applicants) will live for five days in the 90.7-cubic-foot interior of an Aveo (which also has about 12 cubic ft. of trunk space). Mounting the occasional stunts, the teams will vie for the most hits on Chevy's 24-hour Web broadcast of their living quarters. New Aveos await the winners.

Nissan's "7 Days in a Sentra" campaign, handled by TBWA/Chiat/Day, Nissan's agency, aims at a slightly older (20-to-30-year-old) market. The ads feature Marc Horowitz, a photographer's assistant and video blogger who comes home each night to a Sentra (97.7 cubic ft., 13.1

cubic ft. in the trunk) instead of his Los Angeles apartment. The 30-second TV spots, online video clips, and blog entries began airing on Oct. 16. In them, Horowitz is shown having pizza delivered to the car, playing cards with buddies, waking up in his bathrobe. "There was very little scripting," says Michelle Erwin, a marketing manager at Nissan.

Chevrolet spokesman Travis Parman shrugs off the similarity of the campaigns. "Ours is more peer-to-peer," he says, adding that the idea for it was largely generated by students as part of a PR competition held in April by the Public Relations Student Society of America, whose chapters are helping

coordinate the campaign at the campuses.

David Smith, CEO of n planner Mediasmith, says living out of a car for a w is "not that far from reality for some students. And b campaigns, he says, may resonate with commuters whose average car time h grown along with traffic. he cautions, "automotive folks have yet to find an appeal to get to 18-to-20-year-olds," who usually c afford cars. Of the two, Chevy's campaign carries "greater risk," he figures, because there's less conti. On the other hand, he no "If something wild and c happens, it has the poten to hit a home run."

—Sonal R

## QUESTION OF THE WEEK

Does the rapid rise of YouTube, the 18-month-old video-sharing site recently bought by Google for \$1.65 billion, portend a radical change in the media landscape?

—Jessi Hempel and Sarah Lacy

"People who think it's replacing television—that's just crazy. You don't make a commitment to YouTube, like 'It's my YouTube time.' It's on the margin, more like checking your e-mail."

Mark Cuban, Internet entrepreneur; owner, Dallas Mavericks

"I would say there's a damn good chance to get around [copyright issues] at this point. Content wants to go where eyeballs are aggregated. You're already seeing traditional media guys start to break and cut deals."

David Sze, partner, Greylock Partners

"Google and Yahoo! are the new distributors. The key over time is going to be what kind of content deals get struck. We're only in Round 1. [YouTube] is not going to set the terms for how content is distributed forever."

John Battelle, founder, Federated Media; co-founder, Wire





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Would [board member] Jay Keyworth's defense be that he did not read the HP employee handbook?"

—Henri Tchen  
 Fountain Valley, Calif.

### WHAT ABOUT THOSE LEAKY BOARD MEMBERS?

WHILE I DON'T condone "pretexting," I am astonished that all the attention is on Patricia Dunn and Mark Hurd, with relatively none on former HP board member Jay Keyworth ("Controlling the damage at HP," Cover Story, Oct. 9).

It is incredible that after Enron and Sarbanes-Oxley, a director on a Fortune 500 board would deliberately leak boardroom dynamics to the press to embarrass a fellow director or to press his personal agenda and deny it when identified. I believe any chairman or CEO confronted with a similar situation would vigorously investigate it. Confidentiality applies to employees and is usually spelled out in the employee handbook! Would Jay Keyworth's defense be that he did not read the HP employee handbook?

—Henri Tchen  
 Vice-President  
 Synapse Capital  
 Fountain Valley, Calif.

### FIDELITY AND HOME DEPOT BEG TO DIFFER

WHILE BUSINESSWEEK and others may have preferred that the Fidelity funds voted differently on any one of the 50,000

proposals before us this proxy voting son ("Fidelity's divided loyalties," cial Report, Oct. 16), there is no dis the fact that the funds' proxies we without regard to whether the co involved was a client of Fidelity.

For example, the frequency at the Fidelity funds voted proxies in c tion to management was essentia same at meetings of Fidelity's 401(k) and other key clients as it those of all other U.S. companies the most recent annual reporting p

Fidelity's voting decisions—ba guidelines approved and annua viewed by the funds' Board of Trust which 10 out of 13 are independen designed to ensure that company p are voted in the best interest of holders, particularly in circumstar apparent or potential conflict be shareholder interests and Fidelity's ness relationships. The guidelines r that other business relationships tirely disregarded in making voting sions. To that end, Fidelity keep funds' proxy voting process and who carry out this function separat those who manage business relat or who otherwise work with client panies or business partners. Our p

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# ReadersReport

lines require escalation to the Fidelity Legal or Compliance Dept. wherever there is no explicit direction on how we exercise votes, and those situations may also be escalated to the funds' Board of Trustees for review as appropriate.

Notably, the Fidelity board has a committee—composed entirely of independent trustees—responsible for reviewing proxy voting matters, including a comparison of voting results relating to key clients and all other companies. A review of this year's results shows that the Fidelity funds voted contrary to one or more of management's recommended votes at 31% of all U.S. company meetings at which they voted, and the percentage of votes against management at meetings of key clients was essentially the same.

Some tend to view the withholding of votes for the election of directors as the preferred or most effective way to signal concern or dissatisfaction with a particular action (or inaction) by a company's senior management or by its board of directors. But as an institutional shareholder, we have other ways to communicate our views to a company. More broadly, we make decisions every day about the effectiveness of a company's management on

a multitude of issues—not simply a handful of company proposals before us in proxy voting season. If we make a determination that a company is not being run well, we have the option to sell our shares and, in fact, we make such decisions to buy and sell shares daily in the market.

We take our fiduciary duties to shareholders very seriously and work assiduously to avoid conflicts in our other business relationships. The evidence shows that any conclusion otherwise is unfounded and not supported by the facts.

—Stephen P. Jonas

Executive Director

Fidelity Management & Research

Boston

YOUR STORY GOT IT wrong when it implied that an existing relationship between Home Depot and Fidelity Investments affects the way the mutual fund votes in our board of directors elections and on our shareholder proposals.

Home Depot does not have any business relationship with Fidelity. Furthermore, our board members do not have any direct relationship—representing our company with Fidelity—that would influence Fidelity's decisions to invest in

our company or to vote on proxy matters.

Furthermore, the article states Home Depot has lost \$23 billion in market value from the time CEO Bob Nardelli joined the company, in late 2000, through May. This assertion ignores stock repurchases that reduced our outstanding shares by about 15%. The buybacks enabled the company to return more than \$10 billion in cash to shareholders during that period. By confusing the return of cash with the loss of value, you have grossly overstated the impact of the decline in Home Depot's stock price.

We sent this information to your magazine in the form of answers to several questions posed by the reporter. That *BusinessWeek* chose to present our answers resulted in misleading statements that are incorrect.

—Brad

Senior Vice-President

Home Depot

Atlanta

## HEY, INSURERS: A GYM MEMBER IS CHEAPER THAN AVANDIA

IT IS ABSURD that an insurance company would rather pay \$170 a month for a gym membership than contribute to a gym

# Support

Individual flair is all very well, but supported by the right team you're more likely to make it happen.

Make it happen

p, which could produce comparable  
ts with regard to disease preven-  
not to mention vastly improve the  
l well-being of a patient ("The vex-  
cess of Avandia," Developments to  
, Science & Technology, Oct. 9).  
ile Avandia might be successful in  
ating Type 2 diabetes, a change in  
le can contribute more profoundly  
lping to prevent heart disease,  
ension, and some forms of cancer  
l. By providing medication that, in  
takes away the incentive to live a  
ier life, we are surely doing more  
than good.

—Stig Pramming, M.D.  
Executive Director  
Oxford Health Alliance  
London

## VECTOR CAPITAL VES IN COREL

ND THE 'strip and flip' (Corpora-  
ct. 9) did not fairly characterize our  
nent in Corel Corp. The team at  
Capital is fiercely proud of the em-  
s, management, and products of  
Corel is a true Cinderella story,  
rming from a company on the  
of oblivion when we took it private

in fall, 2003, to one that is successfully  
competing with some of the largest global  
players in the packaged software industry.

Through thoughtful product innova-  
tion, sharp execution, and careful merg-  
ers and acquisitions, Corel has increased  
revenue by over 50% since 2003. Pretax  
cash flow has improved from -\$16.9 mil-  
lion in 2003 to \$49 million in 2005, with  
significant improvement continuing into  
2006. Surprisingly, your article focused  
on GAAP [generally accepted accounting  
principles] net income, a measure heav-  
ily distorted by Corel's acquisition history  
and one that no sophisticated software in-  
vestor would track. The enterprise value  
of Corel has grown from \$60 million in  
2003 to around \$375 million today.

It is this outstanding performance that  
has allowed Corel to use debt to finance re-  
turns to our investors and execute a  
sound acquisition strategy that has further  
strengthened the company. The use of  
leverage to finance Corel's growth shows  
Vector's belief in the long-term value of  
Corel's stock. Why issue equity to dilute  
something we believe is very valuable?

You also seemed to imply that Vector  
took a number of actions that ultimately  
detracted from the post-initial public of-

fering performance of Corel. As a 72%  
shareholder of the company, we have no  
such incentive. The bulk of Vector's re-  
turns in Corel are tied directly to the per-  
formance of the company in the coming  
years. In fact, since your article was re-  
leased, Corel's stock price has increased.

—Alex Slusky  
Managing Partner,  
Vector Capital  
San Francisco

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## Building a Better Mouse

Why would anyone spend upward of \$75 for a computer mouse when you can get a perfectly adequate one for \$15? The answer is customization. Logitech and Microsoft are betting plenty of people out there will spend extra money and time to configure their cordless, rechargeable mice to get a bit more control.

In the old days of mechanical mice, I hated them for all their fancy upgrades. No matter how good they were, their delicate roller-ball sensors were always a victim to crumbs, coffee spills, and a simple bump on my desk in a matter of months. All but the cheapest mice use a light (in the case of invisible infrared light in the latest mice) and a miniature camera to sense movement, and they are practically indestructible. I tested four of these newfangled mice, two designed for desktops, two for portable use. All of them share one useful feature: the ability to customize the button functions to suit your needs. Depending on whether you're editing a document on the Web, editing a spreadsheet, or engaged in some other task.

Of the four mice I tested, the most interesting is the Logitech MX Revolution, which sells for about \$90. I was won over by the control wheel, which can either scroll slowly through a document or fly through pages in freewheel mode. It switches automatically between the two styles by sensing what you're doing—a boon when you're working with long documents, such as large spreadsheets.

**OTHER HANDY FEATURES** are the search and zoom functions. A rocker switch on the left side lets you zoom in on any application that supports the feature, such as Microsoft Word and Mozilla Firefox. Pressing the search button with a word or phrase highlighted launches a search for the selected text; otherwise it simply opens up a search page. Logitech undercut this feature by making Yahoo! the only search choice.

The MX Revolution (around \$65), the little brother of the MX Revolution, is meant for laptop use. It has the same basic features as the MX Revolution, although the scroll wheel has to be switched between click and freewheel modes, and it uses a single AA battery instead of a rechargeable battery. The wireless receiver plugs into a USB slot on your notebook, stashes away in the mouse and pops out with the push of a button. Microsoft's newest entry in the deluxe mouse field, the Laser Mouse 8000, is more conventional. Its



**MX  
REVOLUTION**

strongest feature, a carryover from the last generation of Microsoft mice, is a button that pops up a "magnifying glass," which enlarges the portion of the screen that it covers. Unlike the Logitech zoom feature, the magnifier works with any program. And it is ambidextrous, while the Logitech mice are designed for right-hand use.

The Laser Mouse 8000 uses Bluetooth wireless, so it should work with Bluetooth-equipped laptops without requiring the USB receiver. But the setup is harder than it should be. And this is the first mouse I've seen in some time from either Microsoft or Logitech that doesn't work with Macs.

For the ultimate in portability, there's the MoGo Mouse (about \$70), a clever Bluetooth

device that hides inside a notebook's PC Card slot and recharges itself while tucked in its nest. When you take it out and lift a prop that raises the back end about a half inch, the mouse becomes surprisingly comfortable to use. The one drawback is that the MoGo won't fit in the smaller PCExpress slots found in the newest notebooks; the company says an Express version is in the works.

There are all sorts of other aftermarket mice available, including models optimized for game playing. And for many folks, the basic \$15 corded optical mouse with two buttons and a scroll wheel will do just fine. The only thing I'd avoid are the few mechanical mice still left on the market. The crumbs will get you every time. ■

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### What do you get with a \$75 mouse? All those zippy functions

**BusinessWeek online** For past columns and online-only reviews, go to [technology&you at businessweek.com/go/techmaven/](http://technology&you.at.businessweek.com/go/techmaven/). To hear Steve Wildstrom's podcast on his latest column, go to [www.businessweek.com/search/podcasting.htm](http://www.businessweek.com/search/podcasting.htm)







## ESPN's Cell-Phone Fumble

In its 27-year history, ESPN has pushed its brand with the ferocity of a linebacker on steroids. And mostly it has emerged with big wins. But the sports entertainment giant recently admitted to a rare failure in brand extension. Just seven months after launching its own cell phone and service on Super Bowl Sunday, ESPN abruptly announced it was scrapping

its heavily hyped Mobile ESPN.

Becoming your own cell-phone provider—leasing wireless spectrum from one of the big carriers and delivering programming directly to customers—is not for the faint of heart. Very few Big Media brands attempt to become an MVNO, or mobile virtual network operator. ESPN, the \$5 billion-a-year jewel of Walt Disney Co., takes pride in knowing what sports fans like and how they want their games, highlights, and analyses served

up. Yet despite investing nearly \$150 million in Mobile ESPN, say industry sources, the company signed up just 30,000 subscribers, way below a possible breakeven mark of 500,000.

ESPN's decision to go it alone even though it already offers programming through Verizon, Sprint, and the other wireless carriers is akin to Michael Jordan leaving his comfort zone to play baseball. In other words, there are lessons here.

**NOT EVERYONE IS STEVE JOBS** ESPN thought it could get sports fans to pony up for an ESPN-branded phone and premium service by luring them with a cool device and marketing the heck out of it. But the black and red Sanyo phone was chunky and unremarkable. And the \$40 million that ESPN pumped into witty ads did little to stoke the business. Besides thinking it could make a buck on hardware, ESPN figured it would save on the 50% or so share it typically would have had to give to wireless operators to run content on their networks. That savings was crucial since ESPN, as a secondary rights holder, still had to pay the leagues for clips.

**SPORTS FANS HAVE OTHER LIVES** As passionate as sports nuts are, they have other interests and obligations. That was supposed to be the point. At Mobile ESPN's launch, the company said there were plenty of people out there willing to pay for the privilege of getting sports all the time, whether at the grocery store, the kid's soccer game, or waiting for the bus. But even a 19-year-old sports junkie has other



avocations, even if they are just sex and beer. The point is people want to be able to access more sports on a cell phone.

**MAKE SURE YOU BLOW PEOPLE AWAY** Signing up for Mobile ESPN required a big leap of faith. Folks had to pay up to \$199 for the phone and between \$65 and \$225 a month for premium content. Plus ESPN was asking many people to switch carriers and abandon family plans. Research firm Branddimensions reported that 60% of 1,900 consumers it surveyed were turned off by all these factors. If you're going to ask that much of people, they'd better feel they've died and gone to sports heaven. They didn't.

**CUT YOUR LOSSES AND MOVE ON** To ESPN's credit, it didn't waste time when breaking even looked

as likely as making an 80-yard goal. "We discovered [Mobile ESPN] was too limiting," says Raj Mehta, an executive vice-president of ESPN Enterprises. "We can do all the programming we developed and the new engineering in terms of presentation and put it in front of so many more consumers. Just as it did before Mobile ESPN came along, the network will license programming to the

**Mobile ESPN had 30,000 customers, way below breakeven**

carriers but in new ways. Says Mehta: "Stay tuned."

ESPN has turned losers into winners before. Early attempts to get into print included short-lived inserts in Sunday newspapers. That failure led to a magazine with a circulation of nearly 2 million. ESPN2 played rock music and scrolled sports scores when it launched in 1993. Today, it is a fully programmed channel available in 90 million households. And if the company can sell ESPN Burgers and Sudden Death Brownies at its Zone restaurants, then maybe the second coming of ESPN's mobile strategy will find an audience, too.

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JAMES C. COOPER

# A Speedup Is Just Beyond Those Sluggish Numbers

The lighter energy burden will bolster the economy through early 2007

**U.S. ECONOMY** So much for the midcycle slowdown. After four years of solid growth, many analysts had expected the economy to stall abruptly this year, as the Federal Reserve's interest rate hikes took hold. The last time that happened was in 1995, following the Fed's efforts to prevent the economy from overheating. To some extent

that scenario has played out, but maybe not for the reasons analysts thought it would. This year's pullback may have had more to do with the runup in energy prices than the dampening effects of Fed policy. In fact, as the energy situation turns around, the midcycle slowdown, such as it was, is quickly turning into a mid-cycle acceleration.

When the Bureau of Economic Analysis delivers its report on third-quarter gross domestic product on October 1, expect a tepid-looking headline number for overall economic growth, perhaps even less than the second quarter's mild 2.6% advance. But for the fourth quarter, early 2007, at least, the pace is set to quicken as all the drags on the economy begin to lift, or, in the case of energy, become a bit less of a burden.

The GDP report will highlight the two biggest curbs on the economy this year: the housing slump and the rise in energy costs. But while the Fed holds some responsibility for the weak housing sector, it has none for the depressing effect of \$77-per-barrel oil on business and the \$3-per-gallon gasoline on household budgets. And the turnarounds there are helping to set the stage for a livelier economic pace.

**ON THE BRINK OF A PICKUP** are emerging. Recent stock market gains show investors sense a change in the air, a feeling that stock prices already contain all the bad news on the horizon. Small businesses voiced greater optimism in September, and consumer confidence rebounded strongly in October. Households seem especially thrilled by lower energy prices, as the plunge in overall inflation boosts the purchasing power of their paychecks (chart).

Meanwhile, it's beginning to look like the housing market is not the monster waiting to devour the economy. The notion that all the scare stories have made it out to be. Residential investment appears to have subtracted about 0.5 percentage point from overall economic growth in the third quarter, a heavy blow from a sector making up only 10% of GDP. For the current quarter, look for more of the same. Additional cutbacks in new construction will still be needed to shrink builders' inventories, and the price weakness will show up in many existing-

home markets as buyer-seller standoffs continue.

But housing's biggest blow to the economy is very likely occurring right now. Builders' sentiments about market conditions, although at an extremely low level, may have hit bottom in September. They edged up a tick in October for the first time in a year, according to the National Association of Home Builders. Housing starts in September also posted a surprise gain.

**THE IMPORTANT POINT** for the future is this: After nearly a year of this downward pressure, any housing-related fallout on consumer spending has yet to show up. That's because households have had solid support from strong labor markets, an accelerating pace of income growth, and steady additions to wealth.

Now, falling gas prices are adding to the forces

already in place. Indeed, consumer spending is accelerating, not slowing down. It rose at a 2.6% annual rate in the second quarter. The third-quarter rise, which will show up in the GDP report, appears to have been in the 3%-to-3.5% range, and the advance this quarter will most likely be even larger.

That's the implication from September reports on retail sales and the consumer price index. Retail buying fell 0.4% from August, but that decline reflected a record 9.3% drop in the dollars consumers surrendered at gas stations because of the sharp retreat in pump prices. Excluding gas, spending on everything else increased a strong 0.6%, including sizable gains at department and clothing stores. The big advance means overall household outlays headed into the fourth quarter with strong upward momentum.

The September CPI shows why that forward thrust will continue. Reflecting a 7.2% drop in energy prices from August, coming mainly from a 13.5% plunge in gas

## OVERALL INFLATION TAKES A DIVE



\*ASSUMES Q4 CPI IS UNCHANGED FROM Q3  
Data: Bureau of Labor Statistics, Global Insight Inc., BusinessWeek



prices, the overall CPI fell 0.5% last month. In only the past three months, the 12-month inflation rate has dropped from 4.3% to 2.1%. That's about 2 percentage points automatically tacked on to the purchasing power of household incomes—sort of like spending \$100 but getting an additional \$2 worth of goods and services for free.

Retail gas prices in mid-October are already down an additional 12% from their September average, setting up the possibility of another decline in the October CPI. This could mean an overall fourth-quarter CPI no higher, or slightly below, the third-quarter level. That's important in the GDP math for real consumer spending. At that level, inflation will be subtracting almost nothing from the dollars consumers shell out in the fourth quarter, which could result in a bang-up contribution to this quarter's economic growth.

**THE SPRING AND SUMMER POP** in gas prices has affected the economy's performance in other ways—including slower inventory growth and higher imports—that will show up in the third-quarter GDP report. But these weights also will be lifting in the months ahead.

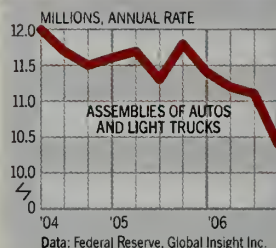
Most notably, the gas-price jump added to the already heavy burdens on the U.S. auto industry. As consumers shifted from gas-guzzlers to fuel-sippers, buyers turned increasingly to imports for the cars they wanted. Auto imports over the past six months have run 8.3% ahead of the same period in 2005, when they were up only 1.5% from 2004. Burdened by weaker demand and ballooning inventories, Detroit cut light vehicle production by 22%,

measured at an annual rate, in the third quarter (chart).

Coming on top of the losses from home construction the auto cutbacks have had a major impact on the health of overall manufacturing, as the effects have worked through the industry's long supply chain. Manufacturing production fell 0.3% in September, and growth for the

third quarter slowed to a 4.3% annual rate from the second quarter. Factory output has continued progressively in each quarter this year, but excluding motor vehicles and parts, production in the third quarter grew the same 5.4% rate as in the second quarter. Moreover, Detroit's output schedules for the current quarter suggest

## DETROIT'S CUTS HAVE BEEN STEEP



the deepest part of its production cuts is over.

What will rejuvenate factory activity in coming months—and propel the overall economy at a faster clip—is continued strength in overall demand. When the GDP report comes out, don't obsess over the lukewarm top-line number for economic growth. Look at what's happening in three categories: consumer spending, business outlays for new equipment and buildings, and exports. Each of those sectors will have grown faster than in the second quarter. Those are the figures that will tell you overall growth is set to pick up. ■

## THE BUDGET GAP

# Trouble on the Tax Front

**THE FEDERAL DEFICIT**, at \$247.7 billion for fiscal year 2006, was less than just about anyone expected. Surprisingly strong tax revenues from individuals and companies accounted for the smaller shortfall for the year ended in September. But last year may have been as good as it gets.

The strengthening U.S. economy helped to fuel strong corporate profit growth and improved wages for individuals during fiscal 2006. Corporate income taxes surged by 27.2% from the prior year, while individual income tax receipts grew 12.6% over the same period.

Revenue increases of that size, however, are unlikely to happen

this fiscal year. Tax receipts from companies had been decelerating throughout fiscal 2006 (chart). For the current year, the nonpartisan Congressional Budget Office expects the receipts to fall just short of the previous-year level.

Individual tax revenues are expected to improve, but not at the same pace, based on CBO projections.

As an economic recovery matures, "revenues cannot exceed nominal growth [in gross domestic product] for a long period," says Milton Ezrati, senior economist at Lord Abbett, an investment management company.

Potential revenue growth

also will be constrained in part by Congress' stopgap move to limit the number of taxpayers subject to the Alternative Minimum Tax on this year's earnings. Ezrati believes a similar move by Congress is likely next year as well. That's good news for potentially several million Americans, but it also means the deficit will widen.

Strong gains in tax receipts are especially needed to keep a lid on deficits, because spending has not slowed. Outlays rose 7.4% in fiscal 2006, vs. an average rise of 6.7% in the five prior years. What's more, federal spending is nearly twice as large as total tax receipts. To cover the ballooning outlays, overall tax payments would have to grow at a double-digit pace for a third year in a row. That has only happened twice over the past 40 years. ■

—By James Mehring in New York

## FEDERAL REVENUE GROWTH HAS PEAKED



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# The Business Week

## News you need to know

EDITED BY HARRY MAURER



**Options Watch** They called him “brilliant” and “a visionary.” But now terms such as “greedy” and “secretive” may stick. **William McGuire** (photo), a physician who built **UnitedHealth Group** into a \$70 billion health-care titan over the last 15 years, quit as chairman on Oct. 15 and said he’d step down as CEO by Dec. 1. His fall came after a law firm’s probe faulted him for stock options that were “like-

ly backdated” to maximize his gain. McGuire’s options were worth an astounding \$1.78 billion at one point; he’ll get to keep around \$1 billion worth after repricing them under his deal with UHC, according to *The New York Times*.

New CEO **Stephen Hemsley**, McGuire’s right-hand man, also may have reaped backdated grants and will now chop them down, too, but the report says he had “little or no role” in arranging them. Elsewhere, the latest executives to depart in the options scandal include **KLA-Tencor Chairman Kenneth Levy** and **Sapient CEO Jerry Greenberg** on Oct. 17.

See “The great CEO exodus,” page 78, and **ONLINE** “Hard times for UnitedHealth,” and “UnitedHealth’s special relationship,” [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Wal-Mart: Deeper into China** The largest retailer in the world, and the most populous nation: A natural fit, right? Wal-Mart, its growth wilting at home, certainly sees it that way. On Oct. 16, *The Wall Street Journal* said the Bentonville (Ark.) behemoth would pony up \$1 billion for a Taiwanese company, **Trust-Mart**, that has more than 100 stores on the mainland. That’ll help Wal-Mart catch up with French rival **Carrefour**, with 200-plus outlets in China to Wal-Mart’s 66. It could also set off a frenzy among other big retailers fearful of getting big boxed out. On the domestic front, Wal-Mart made less pleasant news: On Oct. 13 a

Philadelphia jury said it must pay \$78 million to Peruvia staffers who worked during breaks or off the clock. **ONLINE** See “Wal-Mart shops for China’s top executives,” [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Liz’s New Beau** What does a **Johnson & Johnson** know about fashion? Not much, maybe, but **Liz Claiborne** hired one anyway, naming **William McComb** as its new creative director on Oct. 16.

See “The great CEO exodus,” page 78

**A Chicago Marriage** Cementing its domination of the world’s futures trading, the **Chicago Mercantile Exchange** agreed to buy its rival, the **Chicago Board of Trade**, in a \$1.5 billion deal on Oct. 17. The duo will far surpass Euronext markets, including **Euronext**, which the **New York Stock Exchange** is trying to grab. Customers fear that more power will lead to higher fees, but the exchanges say other markets will bring better prices for traders.

**ONLINE** See “The Merc and the CBOT: Together at last,” [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**A Fatter Gap** Economists say sliding oil prices shrink the trade deficit, but the numbers aren’t showing yet. The **Commerce Dept.** reported on Oct. 16 that the gap between U.S. imports and exports hit another high in August, \$69.9 billion, sending the dollar tumbling. It topped the record of \$68 billion set just the month before. Needless to say, the \$22 billion gap with China didn’t help. Analysts declared that the numbers reflect a slowing economy, and some scrambled to lower their estimate of third-quarter GDP growth rate to under 2%.

**One Tech Titan Up, One Down** It looks as if **IBM** CEO **Sam Palmisano’s** strategy is finally clicking. Big Blue broke out of a sluggish period with strong sales growth and a huge spike in profits. Third-quarter revenues rose 5% to \$22.6 billion, and income from continuing operations leaped 47%, to \$2.2 billion. Software and computer services led the way, though the huge services business is still growing. **Yahoo!**, on the other hand, said on Oct. 17 that it began rolling out a long-awaited new search advertising system, which may help next year. That news was enough to offset a lousy third quarter in which profit fell 38%, to \$159 million, and a bearish outlook for the fourth quarter. Yahoo’s stock fell 5% on Oct. 18.

**ONLINE** See “Yahoo’s Project Panama back on track,” [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Margins Milestone?** Those pesky margin-trading rules in place since the crash of 1929, may get relaxed. The *Financial Times* reported on Oct. 16 that **SEC** agency staff green-lighted a **Big Board** system that could lower margin requirements to as little as 15%, compared with the 25% standard set by the Fed. That would slash trading costs and make it easier for hedge funds and institutional investors to manage complex investment vehicles.



**Nobel for Microcredit** Little loans can change the world. That simple idea won **Grameen Bank** of Bangladesh its founder, **Muhammad Yunus**, the Nobel Peace Prize on Oct. 13. Yunus' bank was founded in 1983 and helped in the microcredit movement, the granting of small loans to poor people with no collateral. Microcredit is spreading fast across the developing world and is predicted to reach 100 million borrowers by the end of 2006.

**ONLINE** See "What the Nobel means for Microcredit," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Pump Less Oil** Fretting about falling prices, **OPEC** held an "emergency" meeting in Doha, Qatar, for Oct. 19. The cartel was expected to announce production cuts of up to 1 million barrels per day, or 4% of its production. It remains to be seen how the cuts will be shared or whether they will be honored, so skeptical traders have kept the price of oil mostly below \$60 per barrel.

**Life's Big Sale** Going, going, gone for \$5.4 billion—the biggest U.S. real estate deal ever. New York insurance giant **MetLife's** auction proved a bang-up success: It announced on Oct. 17 that it would sell its massive **Stuyvesant** and **Peter Cooper Village** development in Manhattan to **an Speyer Properties** and **BlackRock**.

**ONLINE** See "The world's biggest real estate deal," [www.businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

**Freeing Ken Lay** A federal judge on Oct. 17 wiped the slate clean for the late **Kenneth Lay**, voiding his conviction for fraud and conspiracy as chairman of **Enron**. Since Lay's appeal before his appeal could be heard, the judge ruled that the verdict must be tossed. That stops the feds from trying to seize more than \$43.5 million from his estate.

## Diet of the Week

You won't catch **Mickey** or **Minnie** strolling Main Street eating a tofu burger—but you won't be seeing their friends in boxes of icky-sweet cereal much longer, either. **Walt Disney** said on Oct. 16 that it's phasing out unhealthy food served in its parks and will cut back on the licensing of its characters to promote snacks laden with sugar, fat, or other empty calories. The Happiest Place on Earth will now offer up fruit juice with kids' meals.

By 2007 will squelch artery-clogging trans fats in its products. Carrots or applesauce, instead of french fries, will replace fries as the standard side order with meals. Characters like **Lightning McQueen** (photo), from the Pixar movie **Cars**, won't be adorning packages of **Kellogg's Pop Tarts** or **Keebler Chips Deluxe** cookies after 2008 unless the products meet Disney specs. Still, there's no mention of removing the ads for junk food that crowd Disney channels on **ABC** and **Toon Disney**. And no word yet on whether **Winnie the Pooh** will have to give up that pot of honey.



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# GLOBAL WARMING: HERE COME THE LAWYERS

It's the next wave of litigation  
—after tobacco, guns, and junk  
food. Why Detroit, Big Oil, and  
utilities should worry

**BY JOHN CAREY AND LORRAINE WOELLERT**

**T**WO DAYS AFTER HURRICANE Katrina smashed into the Gulf Coast, F. Gerald Maples returned to his hometown of Pass Christian, Miss., to utter devastation. Most of his neighbors'

houses were totally destroyed. His was in ruins. "It broke our hearts and absolutely changed our lives," he says. It also made Maples, a veteran asbestos plaintiffs' attorney in New Orleans, determined to fight back. "I couldn't stand by when my entire cultural history was destroyed by an event that could become more frequent because of global warming," he says.

So when friend and fellow trial lawyer Timothy W. Porter showed up to help with food and water, the two plotted a legal assault. Since Katrina's fury was powered by unusually warm Gulf water, and since such warmth could result from global warming, companies that have pumped the atmosphere full of greenhouse gases like carbon dioxide should be liable for damages, they figured. "To me, Katrina was a clear result of irresponsible behavior by the carbon-emissions corporate economy," says Maples. He recruited suddenly homeless neighbors like Ned Comer and filed a class action on their behalf in federal court in Gulfport, Miss.

The defendants? Dozens of oil companies, utilities, and coal producers, from Chevron and Exxon Mobil to American Electric Power and Xcel Energy. "This is a heartfelt effort," Maples says. "I don't want to leave this global warming mess to my children."

## BROAD ASSAULT

NEITHER, APPARENTLY, do a host of other lawyers, in what is becoming an ambitious legal war on oil, electric power, auto, and other companies whose emissions are linked to global warming. At least 16 cases, drawing on a variety of legal strategies, are pending in federal or state court. It may seem like an unconnected hodgepodge of initiatives, but whether it's a case now before the U.S. Supreme Court seeking to force the Environmental Protection Agency to crack down on greenhouse gases or the effort by a coalition of Texas cities to require cleaner plants than 17 now proposed by utilities, the challenges spring from a common concern: the lack of action in Washington. "This boomlet in global warming litigation represents frustration with the White House's and Congress' failure to come to grips with the issue," says John Echeverria, executive director of Georgetown University's Environmental Law & Policy Institute. "So the









courts, for better or worse, are taking the lead."

It's hardly the first time the judiciary has emerged as the forum for those who have felt stymied trying to address a broad social issue on other fronts. And it's possible that this legal assault will prove quixotic, akin to failed suits by cities to hold gunmakers responsible for gun violence or by African Americans to win reparations for slavery.

## SWORD OF DAMOCLES

BUT THERE'S ANOTHER example that's far more worrisome for polluters: tobacco. When state attorneys general began suing cigarette makers in the mid-1990s to recover smoking-related health-care costs, the litigation was widely dismissed as fanciful. Yet before the decade was out, tobacco companies had agreed to fork over more than \$300 billion and make big changes in the marketing of cigarettes.

What's more, plaintiffs can have an impact without prevailing in court. The mere threat of obesity lawsuits, for example, has sent soft drink and junk food purveyors scrambling to change their products and improve their public images. In fact, the ultimate goal for environmentalists isn't necessarily to win cases but to ratchet up the pressure on business and politicians to impose mandatory curbs on greenhouse gas emissions.

Business is fighting hard to toss the issue of global warming out of the courts entirely. "These kinds of judgments should be made by elected representatives," insists Quentin Riegel, vice-president for litigation at the National Association of Manufacturers. While industry lawyers don't fear any imminent liability, they are taking the litigation seriously. Three big law firms—Hunton & Williams, Jones Day, and Sidley Austin—are coordinating defense efforts on behalf of a group of utilities.

There are signs that others see the writing on the wall. Bryan Cave partner J.

Kevin Healy says he advises corporate clients that they need to take "reasonable" steps to pare back emissions to reduce their legal exposure. And despite the strong opposition to mandatory limits from the White House and key lawmakers, many companies, some with an eye to potential litigation, are privately ready to sign on to such curbs. Louisiana utility Entergy Corp. even took the unusual step of filing a brief supporting the plaintiffs in the Supreme Court case.

As with tobacco, plaintiffs are trying out a variety of legal theories, some quite speculative. Judges and juries, however, particularly in hard-hit areas like the Gulf Coast, may be inclined to sympathize with even legally marginal claims. The Hurricane Katrina suit filed by Maples in Mississippi alleges that the emission of carbon dioxide is a "nuisance" under common law. That's a theory more typically relied on by those seeking to shut down noxious-smelling hog farms or rowdy nightclubs, though it has recently been used to win a big suit against paint manufacturers for lead contamination.

## Hot Seat

A few of the defendants in current cases:

| SECTOR/COMPANY                  | 2004 EMISSIONS<br>(in millions of tons*) |
|---------------------------------|------------------------------------------|
| <b>ELECTRIC UTILITIES</b>       |                                          |
| American Electric Power         | 164                                      |
| Southern                        | 149                                      |
| <b>AUTOMOBILES (U.S.)</b>       |                                          |
| General Motors                  | 108.5                                    |
| Toyota                          | 29.9                                     |
| <b>OIL AND GAS PRODUCTION**</b> |                                          |
| ExxonMobil                      | 152                                      |
| Royal Dutch Shell               | 123                                      |

\*CO<sub>2</sub> and/or CO<sub>2</sub> equivalents

\*\*All global operations, including drilling and refining

Data: CERES, Environmental Defense

**COAL SMOKE** The most dangerous precedent for polluters may be cigarette smoke

The claim global warming nuisance is "a case to bring," Arnold & Porter attorney Michael

Gerrard, who is monitoring the Missouri suit for a corporate client. That's because it will be tremendously difficult to prove that greenhouse gases caused Katrina and if a jury finds that they did, apportion responsibility among polluters. Missouri will have a major win if, in a decision expected within weeks, the judge allows the trial to take place.

In another case, Connecticut and other states have taken on five electric utilities seeking to limit their carbon emissions. San Francisco, a group led by Friends of the Earth has sued to force the Overseas Private Investment Corp. and the Export-Import Bank of the U.S. to consider greenhouse gases emitted by the projects they help finance. Battle is also being waged in California over auto emissions. The state proposed ambitious regulations and was promptly sued by automakers. In late September, Attorney General Lockyer countersued. He alleges harm from climate change, such as reduced water supplies, caused by greenhouse gas spewing from cars.

While these cases are testing uncharted waters, the Supreme Court is tackling a more basic question. On Nov. 29 it will hear arguments in a case Massachusetts and others brought against the EPA, alleging it has failed to acknowledge its authority under the Clean Air Act to regulate greenhouse gases. If the court finds the EPA failed to follow the statute, the agency then proceeds to actually issue regulations, that would be a huge victory forward for environmentalists. Ironically it would probably take some of the steam out of other global warming litigation.

Even more litigation could be in the offing. Stanford University and others plan symposiums on legal responses to global climate change. And Stephen Susman, one of the nation's top lawyers, is making the issue a personal crusade. His firm is representing Texas cities pro bono in their effort to ensure cleaner power plants, and he's looking for other opportunities to help. In the 1990s, Susman defended Philip Morris Cos. in the tobacco lawsuits filed by state attorneys general. He thought his opponents' legal theories were so "bizarre" that they didn't have a chance. "It turns out that I was the fool and I'm not going to let that take place again," Susman says. ■



VESTING

# ETFs THAT TARGET DISEASE

New baskets of stocks let investors bet on breakthroughs

ERLENE WEINTRAUB

**A**RE YOU AN AGING baby boomer suffering from heartburn, overactive bladder, or sexual dysfunction? Imagine being able to invest in a basket of small companies developing cutting-edge treatments for these disorders. A new set of exchange-traded funds (ETFs) will allow investors to funnel dollars into specific disease categories, including cancer, eye maladies, and gastrointestinal and gender-specific disorders. The funds will start trading on the New York Stock Exchange in weeks, getting a green light from the Securities and Exchange Commission.

The new family of funds, called HealthShares and developed by Ferrell Capital Management in New York, is the latest twist in the hot world of ETFs, which are similar to index funds but can be traded like stocks. So far this year, 124 new ETFs have launched, more than double the number that started in all of 2005, according to Morningstar Inc. Upwards of \$5 billion in new assets flowed into ETFs in the second half of October alone, and about 10% of that went into disease-specific funds, reports Bank of America. Nineteen ETFs are health-related, but none is focused narrowly on therapeutic categories like HealthShares.

Why invest in diabetes or the metabolic-endocrine disorders ETF) or for new remedies for depression (that would be a dermatology and mental-care ETF)? Some investment theorists would answer that the best way to generate low-risk

returns is to own a piece of every asset class available, and these ETFs create a new class: diseases.

Ferghana Managing Director William J. Kridel Jr. argues that HealthShares can get investors in early on up-and-coming biotech companies—unlike broader funds that may be overweighted with slow-growth companies. The upper limit on the market capitalizations of HealthShares companies will range from \$10 billion to \$20 billion, depending on the fund. That knocks out most Big Pharma companies and major biotech companies. “You don’t need us if you want [to invest in] Pfizer, Johnson & Johnson, and Amgen,” says Kridel. “We’re exposing investors to the part of the market where there’s growth and innovation.”

Certainly, the new ETFs offer some creative possibilities. An investor who’s bull-

ish on cancer cures but pessimistic about a particular company working on them could buy an oncology ETF while simultaneously selling that company’s individual stock short—a bet its shares will fall. Conversely, someone who thinks the market for oncology companies has gotten too frothy could short the cancer ETF and choose instead to go long on cardio or ophthalmology ETFs.

The downside: The ETFs may be too risky to dabble in without a professional adviser on hand. Some ETF analysts say investors eager to advance cures and also do well in the market might be better off donating some of their savings to research foundations and investing the rest in something safer than biotech. Each HealthShares basket will contain shares of 22 to 25 companies, any of which

could blow up at the first sign of a failed clinical trial. “You could be right about the theme, but end up with a portfolio that doesn’t include the biggest winner,” warns Thomas McManus, chief investment strategist for Bank of America. “Or you won’t have enough winners to offset losses.”

Kridel believes foundations may find HealthShares appealing. Yet that notion seems unlikely to Greg Simon, president of FasterCures, a Washington (D.C.)-based arm of the Milken Institute seeking to speed up scientific research. “A couple of [disease research] foundations might decide it’s symbolically important” to invest, he says. But the financial types managing the endowments could knock down such notions. “Bankers won’t be starry-eyed.” ■

## Homing in on Health

ETFs will invest in treating such disorders as:





## ACQUISITIONS

# A DEAL THAT PAID FOR ITSELF

How one small company took advantage of today's easy money

BY ROBEN FARZAD

**H**ERE'S A LITTLE-KNOWN fact: Google Inc.'s \$1.65 billion acquisition of YouTube Inc. was essentially free. How's that? From the date the rumors started flying until the date the deal was announced, Google's market value jumped by \$5 billion—three times what it actually agreed to spend. This despite the fact that shares of acquiring companies usually fall rather than rise.

Easy money, of course, lowers a deal's risk considerably: Even if YouTube never generates a penny in profit, Google can claim it was a wise move.

While that deal was brewing, another, even more ingenious one was taking place—one that used easy money to buy a chunk of hard earnings. On Oct. 6, Chattem Inc., a small Chattanooga (Tenn.) household goods company with labels like Selsun Blue, Icy Hot, and Gold Bond, announced a \$410 million acquisition of five profitable consumer brands, including ACT mouthwash and Cortizone anti-itch cream, from Johnson & Johnson and Pfizer Inc.

Founded in 1879 as the Chattanooga Medicine Company, Chattem sported just \$27 million in cash and \$300 million in annual sales—numbers small enough to make investors skeptical about its ability to pull off such a big deal. But get this: Its stock shot up 28% on the news. Chattem's market capitalization was \$670 million just

before it announced the deal. When it shelled out the big bucks to make the purchase, its market cap ballooned to \$860 million, effectively handing the company a mammoth instant rebate. To invoke the 1980s group Air Supply, it was like making love out of nothing at all.

Easy credit is a sign of the times. It has bankrolled a record run for private equity deals (page 58) and allowed cash-strapped firms to refinance their way out of pickles. Now it's underwriting small-cap players like Chattem in their quest to make the big time.

In many ways, this deal seems like a no-brainer. Management estimates that it will add 40% to Chattem's revenues. And because the acquired brands carry high profit margins, analysts say the deal could boost Chattem's estimated 2008 earnings per share of \$2.65 by as much as \$1. "We're simply buying trademarks, some inventory, formulas, and a customer list that we'll fold into the business," says Chief Operating Officer Bob Bosworth.

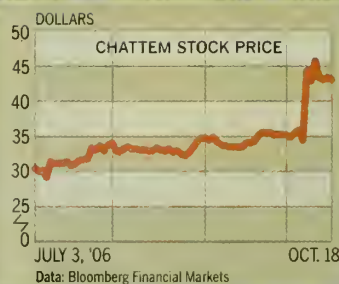
And, taking a page from the private equity playbook, Chattem did it all with borrowed money on easy terms. It had only \$161 million in total debt before the deal, which gave it enough flexibility to take out a \$425 million bank loan at 7.5%. "Clearly Chattem had an underleveraged balance sheet," says Dara Mohsenian, a household-products analyst with JPMorgan, who notes that the company boosted its estimated

debt-to-cash-flow ratio from 1.7 times an expected 4 times with the acquisition. Even so, the new brands will goose Chattem's earnings, absorbing the hit of higher interest payments. That's why investors pounced on the stock. "If you use bank debt and afford this kind of deal, why not?" asks Gary Giblen, consumer products analyst at Brean Murray, Cantor & Co. in New York.

Chattem certainly has a good track record of fixing up orphaned brands. Hot, with \$5 million in sales when Chattem bought it in 1991, now pulls in \$100 million. Gold Bond, which had \$25 million in sales when purchased in 1996, now does at least twice that. It's doubtful that any buyout fund would have the patience or marketing clout to provide what JPMorgan's Mohsenian calls the "Chattem Treatment." Chattem shareholders are feeling cared for as well. The company bought back \$39.3 million in stock year-to-year through the end of August and almost 10% of its share count in the past 12 months. Instead of using equity to pay for the latest deal, it used debt—at a low capital cost. "We do guard our stock price very carefully," says Chairman and CEO Executive Zan Guerry. So it seems. Chattem traded at \$3 six years ago, now it's at \$44.

Who needs private equity, anyway?

## BIG REBATE



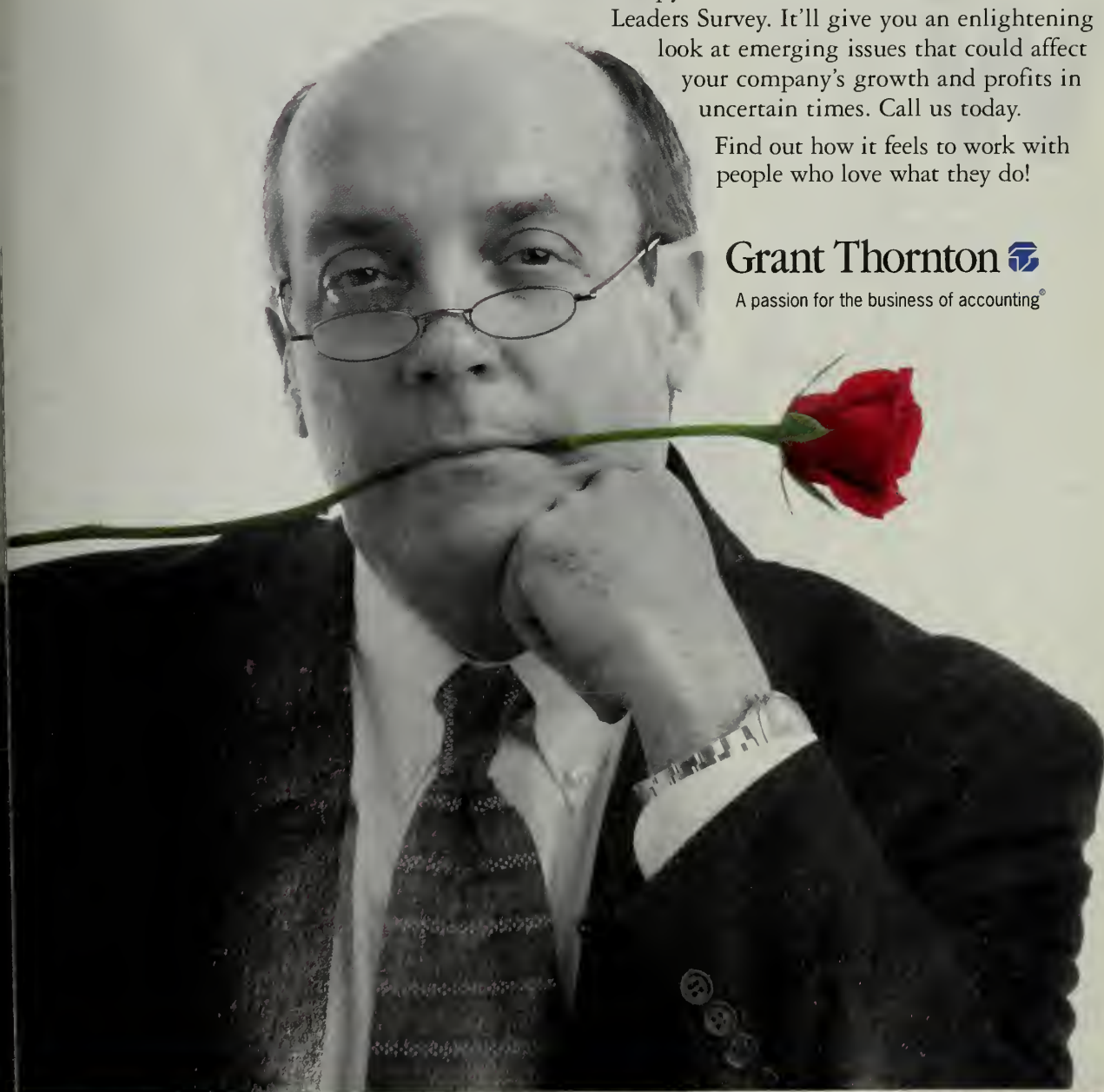
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## NEXT TECH

# WHAT COMES AFTER YOUTUBE

### Meet the startups making deals with Big Media for online video's next step

BY HEATHER GREEN

**W**ITH ALL THE HUBBUB around Google Inc.'s purchase of YouTube Inc., it's easy to think that three-minute, streaming clips mark the culmination of the online video revolution. But what Google paid \$1.65 billion for is more like the king of what works now. And a crowd of startups is hard at work developing Web technologies that will radically change how TV, movies, and other video are distributed, packaged, and experienced in the future. "We're just at the beginning stages of what will be a long evolution," says Joe Laszlo, an analyst at Jupiter Research.

The next few months will see the unveiling of a slew of innovative approaches to dishing up video. They range from the much anticipated launch of something called the Venice Project, by the founders of Skype Ltd., the Internet phone service, to the rebirth of BitTorrent, the video piracy software of choice as a legitimate business. Unlike Napster or even YouTube, both of which rose to popularity on the back of illegally posted content, these would-be video giants are teaming up with established media companies, in part to aid them in their battle against piracy. Indeed, one of the most startling developments over the past year is how Hollywood has loosened up, taking a more experimental approach toward online video distribution.

There's plenty of work still to be done

before video blossoms into its full potential. "What's the advertising model? How does search work? What's the syndication model? It's the same questions asked with the Web in 1995 that startups helped answer," says Josh Bernoff, an analyst at Forrester Research.

Take something as basic as how you track down specific clips. Getting video search right is critical because it is expected to provide the backbone for the sort of targeted advertising that will prop up video sites. But the technology is still primitive. Google dropped the ball by re-

lying on text descriptions, rather than audio or video identification, in its search. That created an opening for startups Blinkx and TVEyes, which look for actual images and spoken words.

## PEER-TO-PEER PRESSURE

**RIGHT NOW**, the startup that's creating the biggest buzz is the Venice Project. That's the code name for a service that expects to launch by the end of this year. Rather than join the 150 YouTube video sharing clones dishing up short, stolen videos, the Venice Project is tackling the problem of streaming videos of nearly high-definition-TV quality in a cost-effective way. It's counting on peer-to-peer technology (P2P), which creates a network of users whose individual computers share the burden of distributing files.

That's no surprise coming from company founders Janus Friis and Niklas Zennström. They are the masterminds behind one of the best-known P2P applications: Kazaa, the infamous music file-sharing service, which eBay Inc. bought for \$2.6 billion a year ago. The services showed how P2P could boost data-streaming speeds while cutting costs.

Unlike Kazaa, the Venice Project won't let people illegally trade copyrighted works. Instead, the company is in talks with media and TV companies to create ad-supported channels for full-length professional content. Individuals can upload videos. "People love to watch," says Friis. "And people love the Internet because of the choice and the social qualities. We're trying to bring the best of both worlds together."

The most dramatic proof of how the video picture shifted is BitTorrent's transformation. Founded by programming whiz Bram Cohen, the company signed licensing agreements with around 20 media companies, including Warner Bros. Inc., to sell movies

TV shows at prices starting at \$1 apiece. Soon it will announce deals to put the Torrent software on DVRs, cable boxes, wireless routers, enabling BitTorrent link up to the Net and download movies or TV shows to PCs and TVs.

Not so long ago, such a collabora-

**The bad boys behind Kazaa are now legit—and soon to be high-def**



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2006156



would have been unthinkable; even today, most files downloaded using BitTorrent are illegal. But Warner hopes that by competing side by side it can convert at least 10% of those users to buyers. "The industry has to be willing to take chances," says Darcy Antonellis, executive vice-president for distribution and technology operations at Warner.

That's a stark turnabout for Big Media, which until recently was focused on tracking down pirates and limiting Web distribution of their videos. Now outfits like Maven Networks Inc. and Brightcove Inc. are helping CBS, *The New York Times*, and Time Warner create Web channels featuring footage that might

have ended up on the cutting room floor or in archives. Powered by Maven, CBS's CSTV lets online subscribers stream live and taped college sports games from 100 schools. The startups also help content owners syndicate videos across the Net, much as the

Reuters wire service licenses its stories to news outlets. "Syndicating video content is where things really get interesting," says Channing Dawson, senior vice-president at Scripps Networks, which runs the Food Network and HGTV. It's examining deals like syndicating home improvement videos to the Web sites of big retailers.

For all the loosening up, entertainment giants are still quick to draw the line with upstarts that may become rivals. News Corp., whose MySpace site is a rich video distribution platform, doesn't feel it has much to gain by doing deals with ad-supported networks like the Venice Project. "If our people are going to wander, we want them to wander to something else we own," says Peter Levinsohn, president of Fox Digital.

These would-be video moguls also face fierce competition from deeper-pocketed tech rivals, including Amazon.com Inc. and Apple Computer Inc. Consolidation is inevitable. Todd Dargatzis, general partner at venture capital firm Spark Capital, estimates that only 10% of today's 300 video startups will survive. Of course, the rest can hope they get snatched up by someone who sees a glimmer of the next YouTube. ■

—With Sarah Lacy in San Mateo and Steve Rosenbush in New York

## MUSIC

# AMERICAN E-IDOL

## Online talent contests hit the big time

BY HEATHER GREEN

**A**MID THE CLIPS OF Christmas song karaoke, martial arts moves, and *Star Wars*-inspired dance steps, true talent lurks online. The trick for media giants has been finding a way to sift through the weird and wacky and find potential stars. Now, Epic Records, Universal Music Group, and EMI are taking a stab at that, teaming with startup media Web site Music Nation to turn online music contests into serious business.

Think of it as *American Idol* for the digital set. But this time around, millions

of people will be able to take a shot at fame, rather than the tens of thousands who line up outside convention halls for an audition for a TV show. In mid-November, wannabe rock, urban, and pop acts will be able to start uploading videos to Music Nation. Clear Channel Communications, meantime, will promote its contest online and on the air.

In January the 15-week contests in three of the three genres will kick off. Web online votes by judges and the audience will determine which singers move on to the next round and eventually win a record deal with Epic. Universal and Clear plan to sponsor contests in Europe and Asia next year. The clips will also be used to create an online broadband channel on the Venice Project, a video startup.

Music Nation won't be alone for a while as a talent showcase. Fox Interactive Media is thinking along the same lines. News Corp.'s digital unit, which bought the karaoke contest site kSolo.com in May, is considering how to integrate the service into MySpace so that it can rev up online contests and feature talent contests like those with *American Idol*. And Bix, a month-old site where individuals can upload their own comedy, beauty, or karaoke contests, says it is hearing from labels and studios eager for prospects.

## "HIGHLY PROFITABLE"

THE NUMBER OF Web content creators, whether sponsored by big brands or put together by just folks, has ballooned recently. So far, though, they have been strictly for marketing and entertainment. This fall, *Survivor* producer Mark Burnett launched *Gold Rush*, an online scavenger hunt that promises \$1 million in gold to the winner who unearths treasure on AOL and CBS. And companies such as Mentos and MasterCard have run contests for consumer-created videos.

Music Nation is now tapping into the enthusiasm to help uncover talent. Of course, create a hot Web destination will use people power to sift through a huge mass of performances that appear on videos, MP3s, and blogs and help labels adapt to the new digital world. Charlie Walk, president of Epic, who provided an advance of under \$1 million to be part of the contest: "At the end of the day, if people love this, it's highly scalable and profitable for us."

Or Music Nation could flop. Web video can be more opinionated than their offline counterparts: They may decide a contest that ends in a label deal is uncool. That's a chance the music industry, desperate to find growth, is willing to take



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## COMMENTARY

BY PETER COY

# Pop. 300,000,000: Sorry, Baby

Why the Census Bureau is probably late—or early—to this demographic party

**N**EWBORN BABIES WITH scrunched-up faces and tiny caps on their heads. Social significance. A big, round number. And to top it off, a breathless, second-by-second countdown. No wonder people went gaga when the U.S. population supposedly hit 300 million at precisely 7:46 a.m. EDT on Oct. 17 (page 132). The portentous moment was celebrated with cake and punch at the Census Bureau and goofy headlines like “Very close but no cigar for Newburgh baby boy.”

Well, sorry, but I’m not buying it. I hate to be a party pooper, but the population clock countdown was a phony. The chance that 7:46 was the actual “300 million moment” is infinitesimally small. The clock could be wrong by not just minutes or hours but weeks, months, possibly even a year or more. To put it bluntly, the Census Bureau’s POPClock is (well-meant) poppycock.

The underlying problem is that it’s easier to measure the mass of Jupiter than it is to get a good fix on the elusive U.S. population. In 2000 the Census Bureau’s count came in at 281.4 million, fully 6.9 million more than the bureau’s own estimate. If population estimates are as wrong in this decade as they were in the last one, then by my calculation the U.S. actually hit 300 million back around May of 2005.

To be fair, Census is probably doing a better job of estimation this decade. For one thing, since 2000 the bureau has dramatically improved its method for measuring immigration. It is us-

ing a new monthly review called the American Community Survey, which gathers information that used to be collected in infamous decennial “long form.”

So let’s be generous and say the population count this time off by no more than plus or minus 500,000. That still means magic moment could be anytime between this past August and this coming December.

The Census Bureau is the first to admit that the POPClock on its Web site and at its Maryland headquarters could be running fast or slow. “Nobody in Suitland [the headquarters] believes it’s down to the minute or anywhere close,” says Howard Hogan, the bureau’s associate director for demographic programs.

On the plus side, the hoopla around that 300 million number gives demographers and their work a rare moment in spotlight. “We kind of joke here around the office that, at least for some time, people will know what the population of U.S. is,” says Carl Haub, senior demographer at the Population Reference Bureau in Washington. He says he has seen

**The chances  
that the child  
born at 7:46  
a.m. was a  
record-setter:  
Slim to none**

estimates by members of the general public “as low as 2 million and as high as a billion.”

So, sure, the population clock serves its purpose. Still, you didn’t catch anything hanging around the maternity wards with the other reporters at 7:46 a.m. on Oct. 17, hoping to grab a bawling sound bite from the first baby born at 300,000,000. Harrumph.



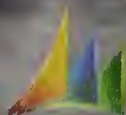
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**BUZZED** Double Coffee's Ustins, a shop in Riga, of 45 in the region

## EUROPE

# GO EAST, YOUNG MAN

Entrepreneurship is thriving from the Baltic to the Balkans, creating many of Europe's growth champions

BY CAROL MATLACK

**C**ENTRAL EUROPE'S economic revival is entering a new phase. Since the fall of the Berlin Wall, low-cost manufacturing and outsourcing have been key drivers of the region's growth. But now, grassroots entrepreneurship is starting to flourish from the Baltic to the Balkans.

That's a key finding of the 2006 ranking of Europe's 500 Hot Growth Companies, a survey of small and midsize growth champions. Two years ago, when *BusinessWeek* first published the list—compiled by Brussels nonprofit group Entrepreneurs for Growth—it contained no companies from the old Communist bloc. In 2005, only one made the list. This year there are 46—from Latvian coffee shop chain Double Coffee to a Czech software

developer to CVO Group, a recruit from Hungary. "What's striking is how many of them are not in traditional manufacturing, but in clever, intellectual businesses," says Steve Hollis, the London-based head of European market consulting giant KPMG.

That's not to say that Western Europe has been shut out. Far from it. Germany, France, and Britain were home to 2 of the 500 companies on the list, v

ks enterprises based on their job-  
ating power over the past three  
rs. And the three Western countries  
ounted for half the 148,700 jobs the  
0 companies created from 2002 to  
05 (for a full list, go to [www.businessweek.com/go/eurogrowth](http://www.businessweek.com/go/eurogrowth)).

This year's list is dominated by small  
panies: Four-fifths have fewer than  
00 employees. And they're bolstering  
ope's economic strength. The 500 av-  
ged an 18% increase in revenue and  
6% in employment, compared with 1.6%  
rall economic growth in the 25 Euro-  
n Union countries last year. Business-  
is diverse as Italian yacht maker Fer-  
i, Spanish nursing home operator  
ercentros Ballesol, and Spreadshirt—a  
man startup that sells customized T-  
ts over the Internet—all made the cut.  
l fully one-third are high-tech compa-  
s, everything from IT outsourcing  
is to systems integration consultants.  
Many of these dynamos are finding  
wth far beyond Europe's borders.  
e Gameloft, a French developer of  
nloadable games for mobile phones  
s No.1 on this year's list. It has built a  
.5 million global business by making  
s with cell-phone operators in more  
1 70 countries and has a half-dozen  
elopment studios on three conti-  
nts cranking out games such as  
ek Jeter Pro Baseball and Prince of  
ia, an action adventure featuring  
riors and princesses that has been a  
n Asia. "Everyone from the Congo to  
ria can play our games," says CEO  
hel Guillemot.

he big change this year, though, is the  
e from the East. Why now? For one  
g, there's more capital to nourish  
all companies in the region. The EU's  
4 eastward expansion helped by giv-  
entrepreneurs a psychological boost  
increasing the confidence of out-  
s. Foreign investment in the EU's  
t new Central European members  
y 20% last year, to \$32.3 billion. And  
ent study by the European Venture  
atal Assn. found that Central and  
ern Europe were the preferred desti-  
ons for new investments by European  
ure funds—ahead of Western Europe,  
and the U.S.

nture money helped Budapest-  
d CVO Group get on its feet. Founded  
96, CVO moved to the fast track in  
when it got \$3 million from a group  
nds including the London-based 3i  
p. Since then, revenues have soared  
y sixfold, to \$17 million, while the  
a grew from 75 to 200, working in  
n countries throughout the region.

The early capital infu-  
sion helped "solidify our  
business and add  
depth," says the compa-  
ny's Scottish-born CEO,  
Norrie Sinclair. That posi-  
tioned CVO to cash in on  
turbocharged hiring by rap-  
idly expanding companies.  
"There's tremendous growth  
here, and we're a barometer,"  
Sinclair says.

## RETAIL VIGOR

THE PUSH BY multinationals  
into manufacturing and out-  
sourcing in the region has cre-  
ated opportunities for suppliers.  
For instance Murdter Dvorak, a  
Czech machine-tool company that  
supplies the region's booming  
auto parts industry, saw its sales  
grow to \$8 million last year from  
\$306,000 in 2002. The good times  
are helping to build a middle class  
that is giving a boost to local retail  
and service companies. Slovenia's En-  
grotus, founded in 1990, has expanded  
from a single store to one of that coun-  
try's biggest retailers and is now adding  
outlets across the Balkans. And Double  
Coffee, which started in Latvia in 2002, has  
45 outlets and is adding locations across

## Cell-phone game maker Gameloft sells in more than 70 countries



the Baltics and the  
Ukraine. "People  
are becoming more  
socialized and  
open," says Nick  
Ustinov, co-  
founder of DC  
Holdings, Dou-  
ble Coffee's par-  
ent. "Riga has

become a modern Eu-  
ropean city." With ambitious young people  
such as Ustinov in charge, Central Eu-  
rope's growth won't cool anytime soon. ■

—With Jason Bush in Moscow

## Hottest of the Hot

Europe's 10 fastest-growing companies

|    | COMPANY       | COUNTRY | BUSINESS               | REVENUES       |
|----|---------------|---------|------------------------|----------------|
| 1  | Gameloft      | France  | Mobile-phone games     | \$58.5 million |
| 2  | Avion Group   | Iceland | Logistics              | \$1.93 billion |
| 3  | Assystem      | France  | Tech services          | \$710 million  |
| 4  | CPL Resources | Ireland | Temporary staffing     | \$132 million  |
| 5  | Spreadshirt   | Germany | Custom T-shirts        | \$10.4 million |
| 6  | EVN           | Austria | Environmental services | \$2.0 billion  |
| 7  | Kögun HF      | Iceland | Defense IT services    | \$287 million  |
| 8  | Webhelp       | France  | Call centers           | \$35.6 million |
| 9  | Group Open    | France  | IT systems             | \$576 million  |
| 10 | Pharmexx      | Germany | Health-care consultant | \$165 million  |

Ranked by jobs added over three years

Data: Europe's 500-Entrepreneurs for Growth



To see the entire Europe's 500 Hot Growth  
Companies list, a slideshow, and profiles of  
top performers, visit [www.businessweek.com/go/eurogrowth](http://www.businessweek.com/go/eurogrowth)

BusinessWeek online





KOREA

## RED-HOT WHITE GOODS

Its linkup with Home Depot has made LG No. 3 in home appliances

BY MOON IHLWAN

**I**N 2004, HOME DEPOT CHIEF Executive Robert L. Nardelli was making the early morning rounds at the Kitchen/Bath Industry Show in Chicago, on the lookout for a new tieup with an appliance manufacturer. Among the brushed-nickel faucets, granite countertops, and maple cabinets, a porcelain-topped washer-dryer set with a chrome-rimmed glass door caught his eye. The maker? Korea's LG Electronics Inc., once known for low-end appliances with little sex appeal. But Nardelli was impressed, LG executives recall, and asked his team to contact the Koreans. "We knew we wanted to add another high-end brand," says Craig Menear, Home Depot's merchandising chief. "LG products are very fashion-forward.... We felt they would be a great addition to our mix."

The alliance with Home Depot Inc. helped LG break into the big leagues. The Korean company's washers, dryers, refrigerators, and more already were selling well in Best Buy Co.'s 700 stores. Then in 2005, LG's appliances hit Home Depot's 1,800 locations, bringing to 3,000 the number of outlets where Americans can buy LG's wares. That has helped the brand grow from no U.S. sales in 2002 to 5.5% of the market for refrigerators and 5.9% for washing machines in the first half of this year. Aided by this stateside success, global sales of LG's white goods hit \$10 billion last

year, up from \$8.8 billion in 2004, propelling the Korean company to the No. 3 spot in the industry, after Whirlpool Corp. and Electrolux.

Even more remarkable is that LG has fueled its growth by going upscale. The Korean manufacturer has targeted consumers willing to spend a few hundred dollars extra for snazzy designs and high performance. LG's sleek washing machines, for instance, now command a 14.1% share of all washers priced above \$1,100. One top LG seller is the Tromm, a \$1,600 energy- and water-saving washer equipped with a "refresh" function that uses steam to remove odors and wrinkles from clothes. To appeal to design-conscious homemakers, the machine comes in titanium, blue, "wild cherry red"—and even plain white. LG's Whisen air conditioners, meanwhile, are thin enough to hang on the wall and double as picture frames.

### 48-HOUR TURNAROUND

THESE PRODUCTS ARE a quantum leap from the cheap GoldStar microwave ovens and toasters that LG used to churn out. "We've concentrated on the premium segment with strong attention to a

**UPSCALE** LG is luring customers with high-end, high-tech designs

high-tech look feel," says Ja Park, LG's president for overseas marketing

underscore its technological prowess has deliberately avoided top-loading washing machines to focus on more expensive front loaders, although the market for the former is triple that of the latter. It has also launched a \$3,000 refrigerator with a built-in TV screen and a \$1,300 combination convection/crowd oven sporting a four-screen that lets cooks browse through scores of recipes.

Another key strategy has been betting big over backward to accommodate retailers. After Nardelli's "aha!" moment in Chicago, Home Depot wanted a guarantee that its customers would receive their LG machines within 48 hours of ordering. So the manufacturer spent millions of dollars to establish or expand warehouses at a dozen key locations across the U.S., and set up a national computer network and a call center. Within six months, it was able to meet Home Depot's requirement.

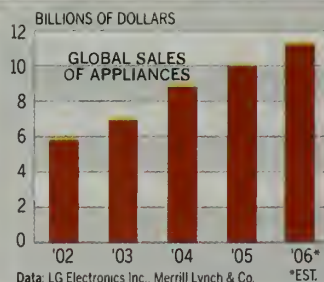
LG could use the lift it's getting from appliances. Though it achieved a winning beating profit margin of 5.9% in white goods last year, topping Whirlpool's 5.5%, the Korean company has been hit by problems at its handset unit and a

quid-crystal display joint venture with Philips Electronics. Because of these setbacks, Woori Investment & Securities expects LG Electronics' net profit to fall to \$245 million this year from \$736 million in 2005. And with Whirlpool's takeover of Maytag Corp., complete, LG will

to fight harder to make its target of capturing 10% of the U.S. market in both washing machines and refrigerators by 2010. "Whirlpool has a lot of muscle in the industry, and we'll have a hard time attracting customers unless we keep rolling out innovative products," says Young No, senior LG manager in charge of U.S. marketing. In other words, there's no getting by on looks alone. ■

—With Brian Grow in Atlanta

### LG HEATS UP



**BusinessWeek** online For a look at some of LG's new household appliances, please visit [BusinessWeek.com/extras](http://BusinessWeek.com/extras)



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## FAST FOOD

# A FINGER-LICKIN' GOOD TIME IN CHINA

KFC, a laggard at home, is making buckets of profit in the Middle Kingdom



BY MICHAEL ARNDT  
AND DEXTER ROBERTS

**A**FTER 50 YEARS OF chowing down on Kentucky Fried Chicken, Americans seem to be losing their taste for Colonel Sanders' secret recipe. Same-store sales at KFC's 5,335 stateside outlets declined 2% in September, and have risen only twice in the last six months. Worse for KFC's parent, Yum! Brands Inc., its other big chains—Taco Bell and Pizza Hut—are also in a slump.

So why is Yum's stock trading near its all-time high? Sheng Yejiang and tens of millions like her could give you the answer. Late one recent afternoon, the 17-year-old and a half-dozen friends were grabbing a quick bite at a crowded KFC in Beijing's swanky China World Shopping Mall. Sheng says she drops in every cou-

ple of weeks because "the service is very good and the food is great."

That sort of loyalty is fueling growth for Yum, which has 1,700 KFCs spread across 400 cities on the mainland. On Oct. 11, Yum reported that its third-quarter operating profit in China jumped 26%, to \$105 million, on a 28% increase in sales, to \$445 million. In the U.S., where Yum has 20,000 restaurants, operating profits rose less than 1%, to \$183 million, while sales fell 7%, to \$1.3 billion. For the year, the Louisville company says, it now expects worldwide earnings to rise 14%, thanks almost entirely to China, where it opens a new restaurant every 22 hours. "We're on

the ground floor of a booming market just like when Colonel Sanders started KFC and Ray Kroc started McDonald's," says Yum Chief Executive David C. Novak, who one day wants to have as many restaurants in China as he does in the

## WHAT ABOUT BIG MAC?

YUM ISN'T THE ONLY American multinational looking to China as an antidote to slowing growth at home. Wal-Mart Stores Inc. is reported to be offering \$1 billion for a chain of 100 Chinese hypermarkets. A huge grocery-department store hybrid. Sales growth at its U.S. outlets, meanwhile, has slackened in the past two years. And General Motors Corp., which at home saw its unit sales in China soar in the first nine months of the year.

That's not the case for KFC rival McDonald's Corp. While bigger, global and ascendant in the U.S., McDonald's trails Yum in China, with just 770 restaurants in some 120 cities. And while Yum's profit margin in China rose 3 points to nearly 24%, in the third quarter, McDonald's puts its return in China in the single digits. "We admit that's much lower than it should be," says H. Matti Paull, McDonald's chief financial officer.

Yum is winning partly because it started an early start. PepsiCo Inc., which spun off Yum in 1997, opened its first KFC in Beijing in 1987, three years ahead of McDonald's. Yum then set up its own supply and distribution system, allowing it to expand quickly into ever-smaller cities. The company has also tailored its menu to local tastes with items such as the Dragon Twister, a sandwich stuffed with chicken strips, Peking duck sauce, cucumbers and scallions. Yum even has a Chicky mascot: a kid-friendly character named Chicky, which Novak boasts has become "the Ronald McDonald of China."

Things might get tougher for Yum as competition heats up.

Competition could heat up as a result of a recent deal in which McDonald's inked a partnership with China's Sinopec, giving Big Mac rights to build drive-through outlets at the oil company's 30,000 gas stations. Also, fast-food chains would be near the top of the list of business casualties in the event of an avian flu epidemic. KFC's China sales plummeted last winter during a scare. But for now, birds in the bucket in China translates into money in the bank back home. ■

## THE STAT

# 26%

Yum's third-quarter operating profit increase in China, compared with a less than 1% increase in the U.S.

Data: Yum! Brands Inc.





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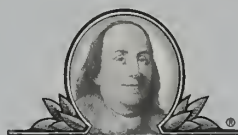
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Source: Morningstar 9/30/06. For each fund with at least a 3-year history, Morningstar® calculates a risk-adjusted return measure that accounts for variation in a fund's monthly performance (including the effects of all sales charges), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive a Morningstar Rating™ of 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund and rated separately.) The fund was rated against 406, 320 and 145 funds and received Morningstar Ratings of 3, 4 and 4 stars for the 3-, 5- and 10-year periods, respectively. Morningstar Rating™ is for U.S. shares only; other share classes may have different performance characteristics. ©2006 Morningstar, Inc. All rights reserved. The information contained herein is proprietary to Morningstar and its content providers; may not be copied or distributed; and is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.



# Horton Hears a Boo

Bearish investors say the builder's land bets will hammer earnings. Management is listening

BY CHRISTOPHER PALMERI

**T**HE QUESTION FOR D.R. Horton Inc., the nation's largest homebuilder, is this: Will pretty bad become even worse? This year the Ft. Worth company's stock is down 35%, it slashed its 2006 earnings forecast 30%, and on Oct. 10 it said that fourth-quarter home sales dropped 25%. Some analysts figure there's more trouble ahead, since Horton made huge investments in land over the past couple of years. Unwinding that bet could mean massive write-downs and sharply lower earnings. "I think 2007 is going to be very painful," says Daniel Oppenheim, a housing analyst at Banc of America Securities.

Donald Ray Horton founded the company in 1978. Over the years he has used acquisitions and aggressive internal growth targets to amplify the effects of the housing boom. From 1995 to 2005, houses sold sprang from 2,500 to 53,200; revenues, from \$437 million to \$13.6 billion; and profits, from \$20 million to \$1.4 bil-

lion. Those results helped the builder win the No. 26 spot on the BusinessWeek 50 ranking of the best-performing large companies. Horton, now 55 and chairman of the company, still inspires his troops with slogans known as "Hortonisms." Among them: "Out of your foxholes—attack!" and "It's a quick trip from the penthouse to the outhouse."

Like a lot of fellow builders, however, as the market roared ahead, Horton began to buy into the notion that land in key markets was in short supply and housing demand would stay brisk. In fiscal 2005 the company increased its land position by 46%, to \$5.1 billion, even though the number of homes it sold rose only 18%. In the first nine months of fiscal 2006, Horton hiked inventory an additional 25%, to \$6.4 billion, even though home sales went up only 6%.

Worse, Horton's land is heavily concentrated in the markets where home sales are falling the fastest. Holdings in Arizona, California, Florida, and Nevada

make up more than half the company assets. Based on current sales it will take the company seven years to liquidate land, figures Credit Suisse analyst Iveta Zelman. That's well ahead of Horton's stated desire to have only three to five years' worth on hand. Much of the land was bought recently, and thus at high prices. Zelman estimates about 48% of Horton's holdings were purchased in 2004 and 2005, versus 28% on average for the other big builders. "Every piece of land they bought in 2005 is underwater," she says.

Horton is now scrambling. The company has reduced the number of lots on which it can build from 396,000 to 340,000. It recently walked away from options it had on 22,000 lots, a move that prompted a \$57 million write-down. Management has vowed to cut \$200 million of expenses from the company's

2006 billion in overhead through head-count reductions and better purchasing.

At the same time, company managers are accelerating strategies that they think will differentiate Horton from rivals. It is expanding into

smaller markets, using the staff it has in place in San Antonio, for example, to build more homes in nearby Laredo. The hope is that sales in those small markets will make up 10% of Horton's business up from 5% this year. Prospective home buyers will also be offered more customization, like turning a garage into a home office or putting a screen around a patio.

Some on Wall Street have spotted a buying opportunity. The argument is that if interest rates appear to have stabilized, as has the overall number of new houses used homes for sale. At a recent 23¢ per share, Horton's stock has rebounded since its July bottom. But the optimists are neglecting another Hortonism, as it seems, the company itself. Horton once told an interviewer: "Walk through the builder graveyard and all the tombstones read 'long and wrong on land.'" ■

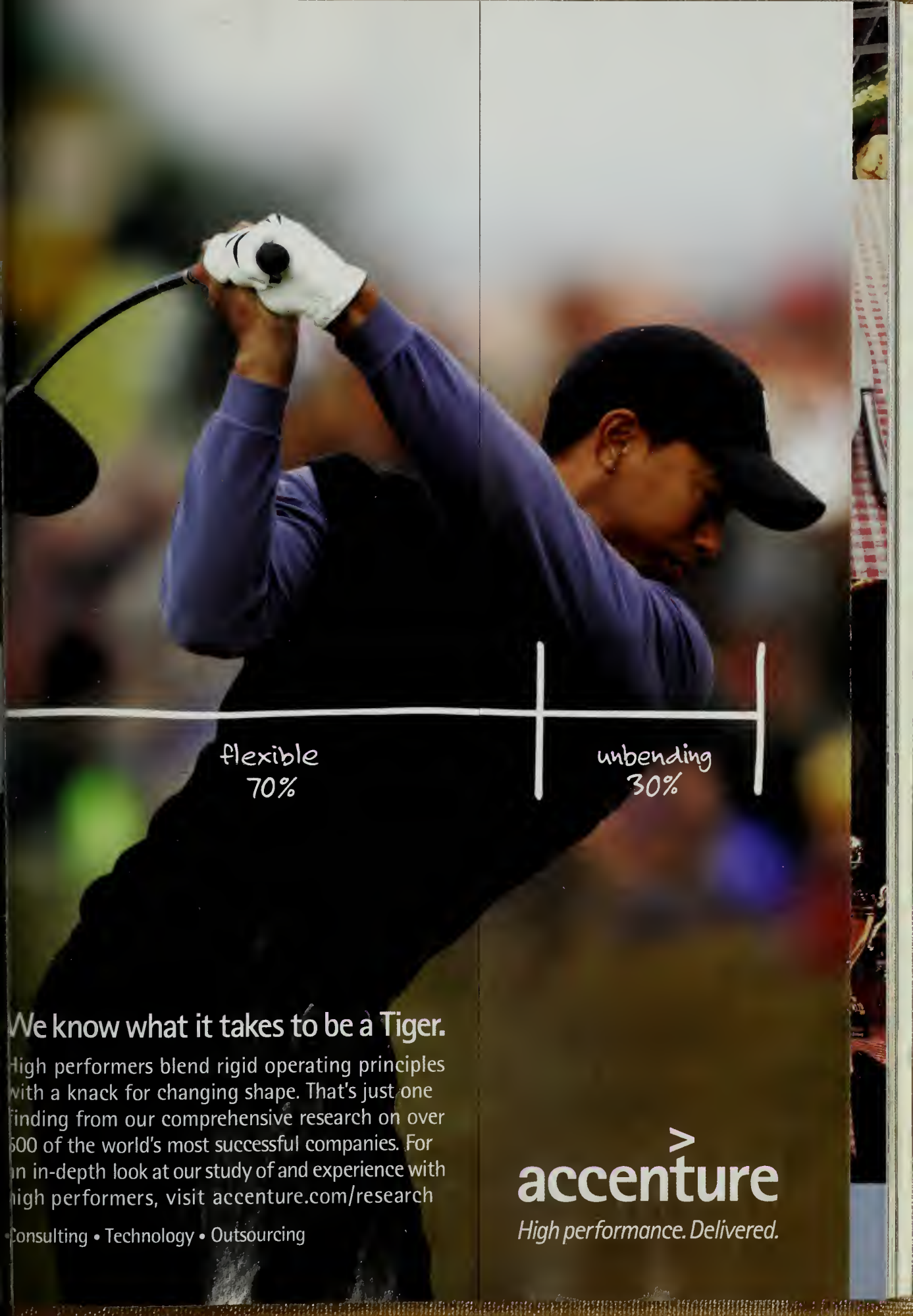


## HOME SICK

It's been mostly downhill for D.R. Horton's stock this year. Some analysts see more ugly surprises to come, thanks to the company's huge land holdings

Data: Bloomberg Financial Markets





flexible  
70%

unbending  
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# Honda's Green (Diesel) Machine

Its new engine is clean and efficient but still could be a tough sell in America

BY DAVID KILEY AND IAN ROWLEY

**H**ONDA MOTOR CO. HAS long sought to prove it's the greenest of automakers. In 1999 the company became the first major car manufacturer to launch a hybrid in the U.S., the Insight, and it has been a leader in developing fuel-efficient—and peppy—engines. But in recent years, archrival Toyota Motor Corp. has stolen the green mantle from Honda with its popular Prius and other hybrids.

Now Honda is trying to take it back. Its technology of choice: the stinky old diesel engine. Or make that a not-so-stinky new diesel. By 2009, Honda plans to sell “clean diesels” in the U.S. These cars will likely go some 30% farther per gallon than gasoline models. The 2.2CTDi diesel-powered Honda Civic, sold now in Britain, delivers 43 miles per gallon in town and 55.4 mpg in combined city-highway driving. The hybrid Civic manages only 50 mpg in combined driving, while a gas Civic averages 33 mpg. “We’re leading the way to cleaner diesel engines,” says Honda Chief Executive Takeo Fukui.

That effort will get a boost from the U.S. introduction of a cleaner diesel fuel this fall. The new government-mandated blend has 15 parts per million of sulfur, down from 500. Honda’s engines have a catalytic converter that filters out enough nitrogen oxide (NOx) emissions to meet California’s new standards—the most stringent in the nation—due to come into effect in the state next year and nationwide in 2009. Unlike other diesels that will meet California’s standards, such as a Mercedes-Benz BlueTec expected to go on



sale in late 2007, Honda’s doesn’t require a separate tank of urea, an organic compound that helps absorb NOx but needs to be replenished occasionally. Instead, its diesel converts some of the NOx into ammonia, then recombines that with what’s left of the NOx to make relatively harmless nitrogen. Honda says the technology will reduce exhaust emissions to levels on a par with gasoline engines. “The Honda system is quite elegant,” says Christopher Richter, a Tokyo analyst at CLSA Asia-Pacific Markets.

Elegant or not, diesel may prove to be a tough sell to Americans. Diesels represent

more than 40% of new car sales rope, where the cleaner brand of t has been available since 1997. But side, diesel still conjures up ima smoke-belching 18-wheelers. Ame of a certain age haven’t forgotten D flirtation with diesel during the which left behind a trail of lemons s an ill-fated version of the Oldsmobi lass. To clean up diesel’s reputati dustry executives have advocated in the fuel with botanicals to make it aromatic and even dropping the “diesel” in favor of something alo lines of “compression ignition eng Price will also be a key factor in g U.S. drivers to make the switch. I hasn’t said how much it plans to r for the new vehicles, but a hefty pre would undoubtedly dampen intere

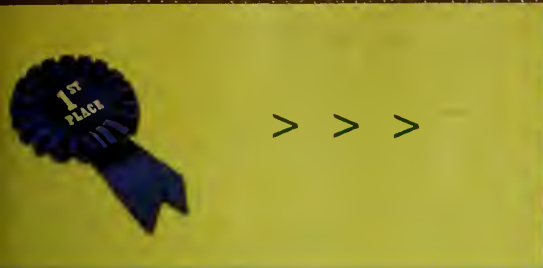
## BUNNIES AND FLOWERS

TO SELL SKEPTICAL Americans, I may borrow a page from its British keting handbook. The carmaker duced diesel-powered cars there in with an award-winning 90-second mated TV spot. The ad shows bu flowers, and rainbows dest smelly diesel engines as Garriso lor, host of National Public Ra *Prairie Home Companion*, cr tune about “positive hat can’t recall any piece of ad ing that changed the who ception of a thing and a br fast and completely as Honda ads,” says Ki Hardy, an independent n ing consultant in London.

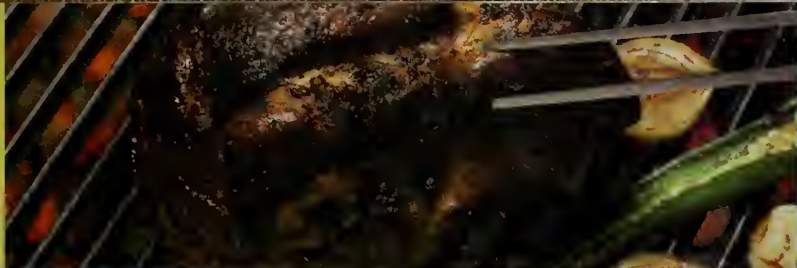
Diesel’s American j nents are hoping Hond achieve a similar feat in t “Honda will be extremel come to the cause,” says Allen Sh executive director of the Diesel Togy Forum, which promotes the the U.S. Honda says it hasn’t yet d how it will market its diesels in the it does decide to pick up the British though, it will likely have to find a pitchman. Toyota’s Prius hybrid is sponsor of Keillor’s popular radio and the writer coined the term “Envy” to describe people who wis were driving the Toyota hybrid. “envy” may get fewer laughs, but l hopes it will sell cars—and bo green credentials. ■

**Honda’s diesel-powered Civic gets 55.4 miles per gallon, compared with 50 miles per gallon for its hybrid Civic**





> > >



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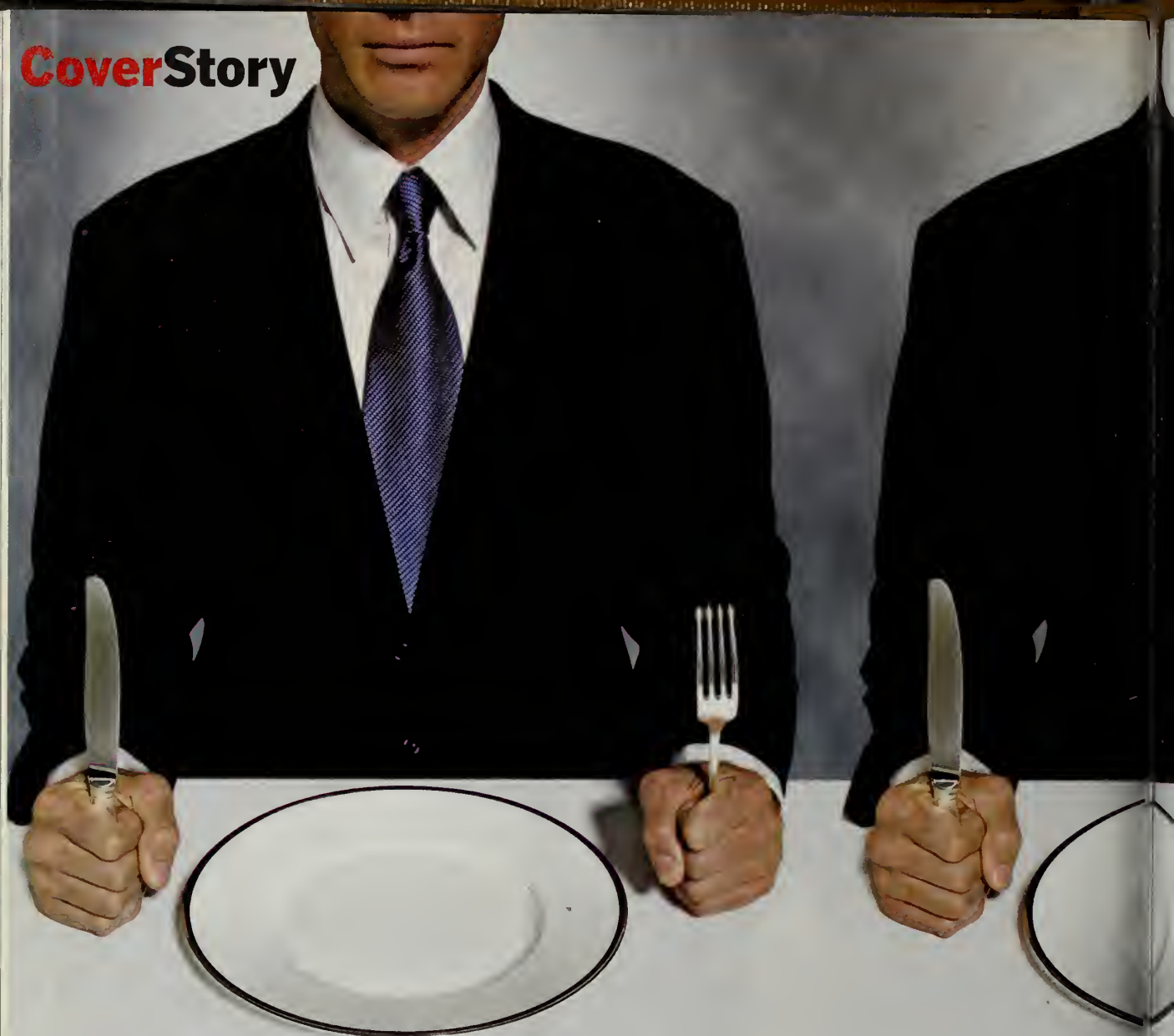
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# Gluttons at the Gate

**Private equity firms** are using slick new tricks

**THREE WEEKS AFTER GIANT** private-equity firm Thomas Lee Partners agreed to buy an 80% stake of Iowa Falls ethanol producer Hawkeye Holdings in May, Hawkeye filed registration papers with the Securities & Exchange Commission to public. The buyout deal hadn't even closed yet, but Thomas Lee was already looking forward to an initial public offering expected to generate a huge profit on its \$312 million investment. The firm didn't just cross its fingers and wait, however. It took \$20 million from Hawkeye as an advisory fee for negotiating the buyout and a \$1 million "management fee"—and will soon take about \$6 million to meet its own tax obligation. All told, Thomas H. Lee will collect payments of around \$



...ge on corporate assets. A story of excess.

**BY EMILY THORNTON**

...n by yearend—despite Hawkeye's having earned just  
...million in the six months through June.  
...ese are crazy times in the private-equity business. It used  
...hat buyout firms would spend 5 to 10 years reorganizing,  
...alizing, and polishing companies they owned before filing  
...e them public. Thomas H. Lee couldn't have created much  
...economic value in the three weeks before the filing, but  
...dn't stop it from writing itself huge checks from Hawkeye's  
...Thomas H. Lee and Hawkeye declined to comment.  
...out firms have always been aggressive. But an ethos of  
...et gratification has started to spread through the business  
...s that are only now coming into view. Firms are extract-

ing record dividends within months of buying companies,  
often financed by loading them up with huge amounts of debt.  
Some are quietly going back to the till over and over to collect  
an array of dubious fees. Some are trying to flip their holdings  
back onto the public markets faster than they've ever dared  
before. A few are using financial engineering and bankruptcy  
proceedings to wrest control of companies. At the extremes,  
the quick-money mindset is manifesting itself in possibly il-  
legal activity: Some private equity executives are being inves-  
tigated for outright fraud (page 68).

Taken together, these trends serve as a warning that the pri-  
vate-equity business has entered a historic period of excess. "It





feels a lot like 1999 in venture capital," says Steven N. Kaplan, finance professor at the University of Chicago. Indeed, it shares elements of both the late-1990s VC craze, in which too much money flooded into investment managers' hands, as well as the 1980s buyout binge, in which swaggering dealmakers hunted bigger and bigger prey. But the fast money—and the increasingly creative ways of getting it—set this era apart. "The deal environment is as frothy as I've ever seen it," says Michael Madden, managing partner of private equity firm BlackEagle Partners Inc. "There are still opportunities to make good returns, but you have to have a special angle to achieve them."

Like any feeding frenzy, this one began with just a few nibbles. The stock market crash of 2000-02 sent corporate valuations plummeting. Interest rates touched 40-year lows. With stocks in disarray and little yield to be gleaned from bonds, big investors such as pension funds and university endowments began putting more money in private equity. The buyout firms, benefiting from the most generous borrowing terms in memory, cranked up their dealmaking machines. They also helped resuscitate the IPO market, bringing public companies that were actually making money—a welcome change from the sketchy offerings of the dot-com days. As the market recovered, those stocks bolted out of the gate. And because buyout firms retain controlling stakes even after an IPO, their results zoomed, too, as the stocks rose. Annual returns of 20% or more have been commonplace.

The success has lured more money into private equity than ever before—a record \$159 billion so far this year, compared with \$41 billion in all of 2003, estimates researcher Private Eq-

uity Intelligence. The first \$5 billion fund popped up in 1999. Now, Kohlberg Kravis Roberts, Blackstone Group, and The Pacific Group are each raising \$15 billion funds.

And that's the main problem: There's so much money sloshing around that everyone wants a quick cut. "For the management of the company, [a buyout is] usually a win-win fall," says Wall Street veteran Felix G. Rohatyn, now a senior adviser at Lehman Brothers Inc. "For the private equity firm, it's a wonderful business. The risk is ultimately in the margin—they leave themselves to deal with bad times."

## BRIMMING WITH CASH

BUYOUT FIRMS ARE IN business to generate returns for their investors, pure and simple. The faster they can do it, the better. During the boom of the 1980s, firms were fewer, smaller, poorer. Their main strategy was to take over a company, issue a ton of high-interest-rate bonds, and then, over many years, to produce enough financial improvements to make the company pay off by selling the company or taking it public. The firm would pay themselves dividends from time to time, but usually after making at least some progress toward the larger goal.

Today firms are brimming with cash, and they're sinking more of it into bigger companies—in many cases even joining together in "club deals." With more skin in the game, they're extracting what they can, as quickly as they can, from companies to satisfy their investors. And since they're buying bigger companies,

# Dividends Many voracious buyout firms are leaving companies depleted

...unts are soaring. Some justify it with euphemisms such as "early return of capital." Critics liken it to strip mining and dividends and other fees are becoming goals in themselves. "You can make a lot of money just on the fees," says Kaplan. "The problem is how much of that is driving [buyout] activity."

Now that the largest firms have as much as \$30 billion in assets, their 1% to 2% management fees alone guarantee hundreds of millions of dollars annually. The average pay of a managing general partner at a big private-equity firm rocketed to \$6.1 million in 2005, up 93% from 2004, according to a compensation research outfit Holt Private Equity Consultants. Along with the old familiar names like KKR, Carlyle Group, Texas Pacific are fast-rising firms like Vector Capital, Vericapital, and Tennenbaum Capital Partners.

One way to gauge today's potential dealmaking power compared with the past is to analyze the capital commitments buyouts make to buyout funds as a percentage of the stock market's total value (chart, page 66). By this measure, today's firms are more powerful than ever before, half-again eclipsing the 1987 peak. Yet deals are being done with much less leverage than was used during the 1980s. That suggests buyout firms could get a whole lot stronger. Some speculate that a \$90 billion deal is possible, dwarfing the record \$33 billion paid for the retail chain HCA Inc., including debt.

The consequences of the fast-money mentality could be troublesome.

Intentionally or not, the corporate raiders of the past did some beneficial things for the business world. Then as now, their sole purpose was to generate returns, but they often succeeded in adding value to the broken companies they bought. Besides their massive layoffs and other cost-cutting spread, raiders frightened corporate executives into making efficiency improvements preemptively—helping the U.S. economy in its strength. At their best, private equity firms managed to impose discipline on others.

Now many seem to be leaving companies worse off. The success of companies buyout firms have taken public are way from the historical pattern. From 1980 to 2002, buyout-backed IPOs outperformed non-buyout-backed IPOs, according to a study by Josh Lerner of Harvard Business School and Jerry Cao of Boston College. True to form, they've also beaten other IPOs

from 2003 onward, by nearly four percentage points, according to Thomson Financial Corp. But in 2006, buyout-backed IPOs are trailing other IPOs by nearly 10 percentage points. It's no wonder performance is slipping: With firms finding ever-more-novel ways to reclaim big chunks of their initial investments quickly, their incentive to produce lasting improvements may be diminishing. Too many appetizers spoil the meal.

And while the leverage being used in deals is much less than in the '80s, many buyout firms are loading up companies with debt after the fact to finance their big dividend and fee payments. Banks have lent companies \$71 billion since 2003 to pay dividends to private-equity owners, up from \$10 billion during the previous six years, according to Standard & Poor's LCD, which, like *BusinessWeek*, is a unit of The McGraw-Hill Companies. Credit ratings are falling fast. And while debt defaults are still ultralow by historical standards—around 1%—they're sure to rise. "If you look at the overall phenomenon, it has to mean an increase in defaults," says Solomon B. Samson, chief rating officer of corporate issuers at S&P. "And now that you have larger companies that are taking these big risks, you'd expect some of them to fall off the cliff." When that happens, employees and debt holders will suffer.

## FAT, FATTER, FATTEST

BUT FOR NOW, BUSINESS is booming, and signs of excess are popping up all over. The most glaring are the dividends. Once unthinkable, the \$1 billion threshold has been crossed several times now. Most recently, in June, Clayton, Dubilier & Rice, Carlyle Group, and Merrill Lynch collected \$1 billion just six months after buying rental car company Hertz Corp. for \$15 billion. With the dividend, the trio earned back almost half of the \$2.3 billion they put up in cash. All of the buyout firms declined to comment on the transaction, as did Hertz.

Fees, meanwhile, are getting bigger and more creative. Nowadays, when a private-equity firm buys a company, it typically collects a toll for giving itself advice on the deal, sometimes more than investment bankers receive. Blackstone Group took \$45 million from Celanese Corp. for its advisory work on its own deal in 2004, more than twice the \$18 million Celanese paid Goldman Sachs, its adviser. Warner Music

## Warning Signs As private equity firms become more powerful, several distinct trends have emerged that suggest the industry is running unchecked

### LARGE DIVIDENDS AND FEES

Firms are pulling record sums from the companies they buy. In one case \$1 billion. They're charging enormous fees for everything from dispensing cash to covering their taxes.

### SERIAL CHARGES

Buyout firms are collecting big payments from companies several times a year, sometimes so much that it impairs the companies' financial strength.

### DEBT BOMBS

Firms are loading up companies with so much debt that their credit ratings are suffering; some of them are even ending up in bankruptcy.

### QUICK FLIPS

Firms are bringing private companies to the public stock market at record speed, in some cases less than a year after buying them.



paid its owners, Bain Capital, Thomas H. Lee, and Providence Equity Partners, a \$75 million advisory fee. Blackstone, Bain, Providence, and Thomas H. Lee declined to comment. (In March, Thomas H. Lee left the firm he founded and started a buyout shop called Lee Equity Partners.)

Private-equity firms are beefing up charges for management expertise, too. In 2005, a trio of private-equity owners of SMART Modular Technologies collected nearly \$3 million for this purpose, more than the \$2 million in total that the five members of the company's management team earned that year. SMART Modular CEO Iain MacKenzie says there are no hard feelings toward his bosses. In his view, the company's owners deserved more because they shepherded SMART Modular through a restructuring. "We, as a management team, would not have had the knowhow, the financial acumen, and the pressure to bring about that level of change," he says.

## DIP AND DIP AGAIN

PRIVATE EQUITY FIRMS EVEN charge companies for no longer taking their advice. Specialty pharmaceutical maker Warner Chilcott's four private-equity owners—Bain Capital, Donaldson, Lufkin & Jenrette Merchant Banking, JPMorgan Partners, and Thomas H. Lee—recently collected \$27.4 million as compensation for terminating their advisory arrangements when the company went public in September, even though the company is unprofitable. All four firms declined comment.

To be sure, most firms still pay attention to operations. Texas Pacific Group bought J. Crew Group Inc. in 1997 and spent nine years fixing it up before taking it public in June. The firm rejiggered operations so thoroughly that public investors couldn't help being impressed; the stock has zoomed 64%. "People in private equity want to make money based on value creation, not fee income," says private equity veteran Robert Finkel, managing partner of Chicago's Prism Capital Corp. "But," he says, "there are those who focus more on the latter than they should."

As the list of occasions for gathering fees and dividends grows, many firms are going to the well often, sometimes within months of their previous collection. At satellite operator Intelsat Global Services, a pack of private-equity owners—Apax Partners, Apollo Management, MDP Global Investors, and Permira

Advisers—accumulated \$576 million in dividends and fees in multiple installments within a year of buying it for \$513 million in 2005. This, despite the company's posting a \$325 million loss last year. Intelsat has \$360 million in cash, while its debt has doubled, to \$4.79 billion. The new load led to multiple cuts in the company's credit rating. In February, Intelsat said in filings with the SEC that it reduced its workforce by 20%, laying off 1,379 people, to "optimize margins and free cash flow."

Like many other companies owned by private equity firms, Intelsat says struggles with profitability are unrelated to the high debt burden brought about to finance payments to its owners. Layoffs were necessary for the company to make the transition from an intergovernmental organization to a company run for profit, explains Intelsat spokeswoman Dianne J. VanBeber. Besides, she says, Intelsat has enough cash to support the payments



*soul-stirring*

*mind-numbing*

# Serial Charges

The list of reasons for fees grows and grows

"The company generates strong free cash flows, and since our capital expenditure cycle was largely completed, cash would continue to build on our balance sheet. Our owners took advantage of this and used the opportunity to give some of the free cash flow to themselves." Through VanBeber, Intelsat's owners declined to comment.

Many firms tap the public stock markets to bail their companies out of debt. Thomson Financial estimates that 55% of the proceeds from this year's buyout-backed IPOs were used, at least in part, to make payments to financial owners and creditors, vs. 21% of non-buyout-backed IPOs.

The case of San Francisco's Bare Escentuals Inc. shows how reliant firms have be-

on public stock investors. In 2005 the cosmetics maker took \$12 million in debt, mostly to pay its owners, Boston's Berk Partners and San Francisco's JH Partners, a total of \$309 million in dividends and "transaction fees" in two installments months apart. The payments were a stretch for a company that earned only \$24 million in 2005. In September, 2005, Standard & Poor's revised its outlook for the company to "negative," "stable," citing its "very aggressive financial policy." Bare Escentuals' owners, who bought the company in June, kept coming back to the trough. In June, 2006, despite a decision in May to lower the company's credit rating from B- and the company's soaring debt-payoff costs, Bare Escentuals began to borrow again to pay its owners even larger amounts: a \$340 million dividend, \$218,000 in management fees, and \$1.8 million in stock for arranging the dividend.

On Sept. 29, investors picked up the tab through an IPO. Most of the money raised was used to repay debt, except for \$1.8 million that went to the owners "as consideration for the termination of our management agreements with them." Bare Escentuals and its owners declined to comment on the payments. For now, the company is doing well both by its public investors and its owners. Its stock has jumped 44% since the IPO.

Most investors in buyout-backed IPOs have not been so lucky this year. Poor performance comes at a time when private-equity firms are attempting to rush companies into the public markets at warp speed. No one is likely to match the Thomas H. Lee-Hawkeye Holdings record of three weeks anytime soon. It's a special situation, perhaps, because the two were seeking to take advantage of the red-hot ethanol market. But other fast deals have raised eyebrows. Medical-device maker Alphatec Holdings Inc. went public in June, 15 months after being bought by Healthpoint Capital Partners Inc. In 2005, Alphatec paid Healthpoint a total of \$2.6 million in various advisory fees and rent. Its stock has plummeted 63%. "The way in which the market has valued the company is concerning and disappointing for us," says Alphatec Chief Financial Officer Steve Dixon, who points out that Healthpoint Capital maintains a 38% stake in the company.

Similarly, government services provider DynCorp International Inc. filed its preliminary prospectus seven months after Veritas Capital Fund bought the company for \$775 million in cash and \$75 million of preferred stock in February, 2005. DynCorp paid \$12.1 million in fees in 2005, even though it

## Private Equity Goes Over the Top

**Insider Trading:** The SEC is looking into private equity deals.

**How Big Is Big?** A slide show ranks the top 10 buyout firms.

**Paydays:** Take a peek at how much private equity executives earned last year.

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posted a loss of \$3 million from February to April that year. DynCorp International's stock has tumbled 22% since its May IPO. Veritas Capital President Robert B. McKeon attributes the company's flagging stock price to an overall decline in the IPO market and in shares of middle-tier defense companies.

The big fees and quick flips are obvious attempts to unlock value right away. But the way the fees are funded is the real problem. Some buyout firms have loaded up companies with so much debt that they're ending up in bankruptcy or are about to. Already, a number of companies have been forced into Chapter 11 because their growing debt left no room to deal with operational challenges such as sudden spikes in raw material prices.

In February, 2004, for example, 16 months after San Francisco's Fremont Partners bought nutrition-bar maker Nellson Nutraceutical Inc. for \$300 million, the company borrowed \$100 million in part to pay Fremont a dividend of more than \$55 million, according to a creditor's filing in bankruptcy court. Nellson rationalized the dividend as a way to provide Fremont "an early return of capital" and to reduce Fremont's "risk in the investment," according to the filing.

But Nellson's energy bar sales went into a tailspin not long after the dividend. Eight months later, it was breaking loan agreements, according to bankruptcy filings. It filed for Chapter 11 protection in January. Fremont and Nellson declined to comment.

As one might expect, the fallout of the bankruptcy has been painful. Nellson owned a plant in tiny upstate Ira, N.Y., and was the town's largest employer, according to Cayuga County legislator Paul Dudley. The plant shut down in March, 2005, and the space remains vacant. Says Dudley: "It was a good source of employment for about 100 people. How many were able to get new jobs I don't know. This is a rural community, and people no longer have the luxury of working [just] two miles from home." On Oct. 16, the U.N. issued a warning about the potential economic dangers facing countries because of private equity firms' short investment time horizons.

Buyout shops have always been associated with job losses, but they've always rationalized them as necessary steps to make companies stronger. There's no way to defend what some critics allege has become a new tool in the private equity kit: intentionally driving target companies into bankruptcy to seize control of their assets. The name for the practice on Wall Street is "loans to own." By making a secured loan directly to a company, a firm can vault itself to the top of a company's capital

## Debt Bombs

Some firms load companies up with so much debt they land in bankruptcy

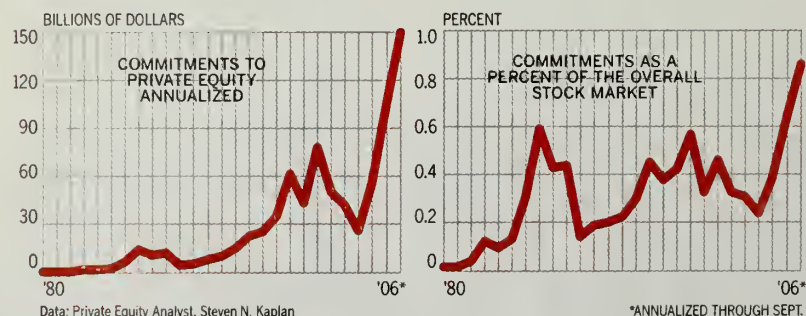
structure. Should the business go under, loan holders have dibs on the remaining assets; only after they take their cut do the claims of creditors with unsecured debts considered. With so much money in private equity right now, "more firms interested in take-control strategies," says Lisa G. Beckert, partner at law firm Akin Gump Strauss Hauer & Feld.

At Radnor Holdings Corp. in Radnor, Pa., debts to private equity firm Tennenbaum Capital Partners have sparked controversy. Radnor makes disposable cutlery, Styrofoam cups and the like. In October, 2005, Tennenbaum made a \$25 million equity investment in Radnor that allowed it a seat on the company's board. Two months later, it lent Radnor \$95 million, with Radnor's machinery property used as collateral. Then in August 2006, it lent an additional \$23.5 million for high fuel, transportation, and resin products that squeezed Radnor's profit margins. To meet its needs, Radnor shuttered one plant and reduced its workforce by 10%, or 67 people, Radnor declined comment.

By August, the company was forced to file for protection under Chapter 11. Soon afterward, Radnor announced it had accepted a \$225 million bid from Tennenbaum for all of its assets. A group of unsecured creditors alleged in a filing with the bankruptcy court in Delaware that Tennenbaum engaged in

## Gold Rush

The amount of money investors are committing to private equity funds has reached record highs



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"carefully scripted effort to force the debtors to shed legitimate arms-length financial and other obligations in order to facilitate Tennenbaum's acquisition of the debtors' cleansed assets."

"You can call us dumb, but you can't call us venal," says founder and senior managing partner Michael E. Tennenbaum, who insists his firm made the loans in good faith. "In 10 years, we've had a handful of times where we have had to foreclose, and we don't like it."

With small blowups like Radnor happening more often as firms push boundaries further and further, experts are beginning to assess the potential damage. "We're at a cyclical high," says Andrew Metrick, professor of finance at the University of Pennsylvania's Wharton School. "Whether that results in a storm or a soft landing is unclear."

Already, private equity returns are starting to cool. On average, funds lost ground in the second quarter, according to a Merrill Lynch report. "You have, at this point, a record amount of money committed," says Kaplan of the University of Chicago. "In the past, there were two other times when you had

that much money—in 1987, and 1998-99—and in both cases returns weren't so good." After a few more down quarters and inflows that have pumped private equity to absurd heights, might start slowing down.

Of course, if returns suffer for too long, firms might grow even more desperate to engineer some quick fixes. If the troubling trends that have emerged in the past year persist, public shareholders and bondholders, not to mention the employees of affected companies, could be in for real trouble.

John Adler has to straddle many competing interests. As director of a private-equity team at the Service Employees International Union, he's responsible for keeping the union's returns strong. He also might be buying into some of the very investment firms that could jeopardize jobs of the people he serves. For now, though, he's taking the excess of the private-equity market in stride. Says Adler: "Putting the right opportunities together with the right capital could really be a good situation for our members. Private equity owns a huge swath of the economy, and it's growing." ■

## Looking Out for Number One

**T**he private-equity gold rush is encouraging some fund executives to cross the line. While cases of fraud at private equity firms are rare, some schemes are outright brazen. Consider the case of John A. Orecchio. On Sept. 8, the Securities & Exchange Commission charged the 40-year-old president and co-owner of AA Capital Partners Inc. and the firm with fraud, alleging that at least \$10.7 million had been misappropriated from pension-fund investors.

Chicago's AA Capital Partners carved out a small but comfortable niche in the world of private equity. The firm manages \$194 million for six unions. When Orecchio asked clients to put \$68 million in trust accounts to be used at the firm's discretion for "capital calls," it appeared to be business as usual.

But law enforcers allege much behind-the-scenes malfeasance. A total of \$5.7 million was allegedly diverted from clients' trust accounts between May, 2004, and October, 2005. Some of that went to a horse farm in Michigan and a company that manages a strip club in Detroit, both of which were owned by Orecchio. He allegedly described the money to his chief investment officer as "reimbursements" for what he claimed was a miscalculation of taxes, and



### Fraud Allegations

Charges of outright stealing taint some private equity firms

the CFO carried out the money transfers. The SEC alleges an additional \$5 million in client funds was used to cover a shortfall between the firm's revenues and operating expenses.

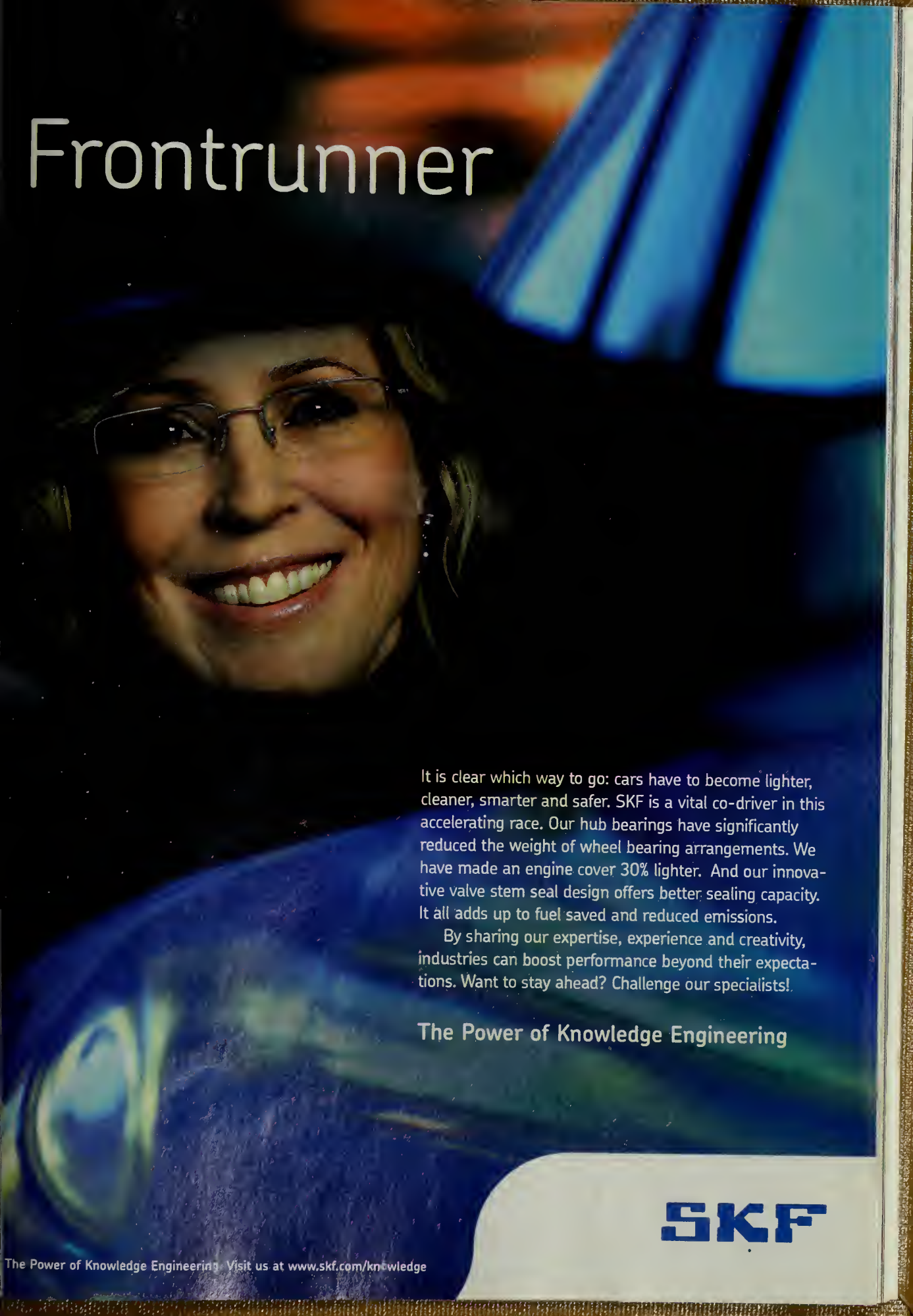
The SEC asked a judge to appoint a lawyer to take control of AA Capital. The lawyer has since brought in forensic accountants to comb through AA Capital's records. Among the items: \$4.3 million in travel and entertainment expenses that

Orecchio racked up in 2006, \$1 million of which appeared to be routed to interest groups such as the Michigan Democrats and Citizens for Greater Detroit. Hundreds of thousands of dollars went to private-plane rentals and visits to nightclubs in Las Vegas. "We know how much [money] is left," says the court-appointed lawyer, W. Scott Porterfield, although he declines to reveal the amount. The more complicated question, he says, is to what extent investors' money was commingled, devoted to Orecchio's many personal expenses, or disguised as "capital calls." Through his lawyer, Orecchio declined comment.

AA Capital Partners isn't the only one tainted by fraud charges. In June, 2005, Todd Berman, a founder and partner of the New York private-equity firm Chartwell Investments, began serving a five-year sentence in a Pennsylvania prison for stealing more than \$3.6 million from the firm, its portfolio companies, and its investors. Berman pleaded guilty to fraud charges brought by the Justice Dept.

For 18 months, Berman misled Chartwell's investors concerning the financial condition of one of the firm's portfolio companies by falsely claiming it needed to borrow funds to meet operating expenses. Instead, Berman transferred the money to his personal bank account, along with fees paid by portfolio companies. Berman also charged some 600 personal expenses to the companies and the firm, many of which were incurred while he was on vacation. They included a private-jet bill for \$78,795 for a trip to South Africa and an \$80,468 bill for a trip to Antigua, according to the Justice Dept. Berman could not be reached for comment. Chartwell Investments declined comment.

# Frontrunner

A woman with glasses and a smile is shown from the chest up, wearing a blue racing suit. She is positioned in front of a blurred background that appears to be the interior of a car, with blue and orange light streaks suggesting motion.

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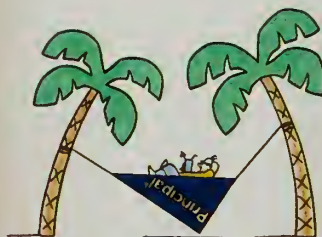




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# Ford on the Web, Warts and All

In place of banal car campaigns, an edgy site with an unvarnished docudrama approach

BY DAVID KILEY

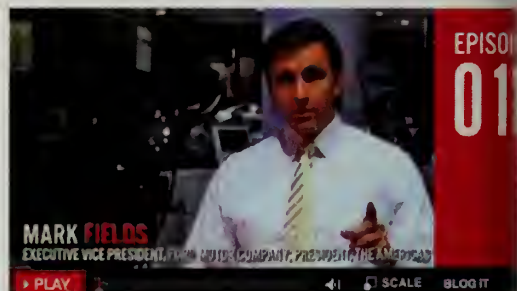
**D**OCUMENTARY FILM-maker Kathryn O'Kane and a film crew roved around a hall full of Ford auto workers. It was Oct. 10, and weeks earlier the employees had learned that their 81-year-old pickup truck plant in Norfolk, Va., would be shuttered at the end of next year. Not surprisingly, some of the workers the crew met were emotionally shattered. Others were hopeful, plotting career changes and going back to school on Ford Motor Co.'s buyout offer.

But O'Kane is not working for a news crew or an independent filmmaker. In a few weeks, footage of the workers she shot will find its way into the final edit of a short Internet film that Ford, her client, will post on [www.fordbold-moves.com](http://www.fordbold-moves.com). The site, launched by the reeling automaker last June, contains films, articles, blogs, and message boards that promote Ford's vehicles and brand but also show some of its warts. The exercise, which tracks Ford's attempted turnaround, is an example of what Ty Montague, chief creative officer at Ford ad agency J. Walter Thompson, refers to as "brand journalism."

The site came out of a charge President of the Americas Mark Fields gave his team and ad agency last December. He asked that, besides creating a new brand platform, they shift Ford's tradition-

al—some would say banal—sales-en advertising to something that would resonate even with Ford's critics. "It is an iconic brand, but to be a respected, authentic brand in the consumer mind," says Field, it "needed to take a varnished look" at itself, as consumers

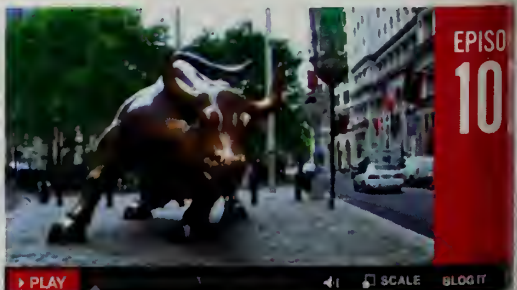
Some of the Webisodes certainly that. In one, titled *Fist Full of Doubt*, a Wall Street analyst discusses why



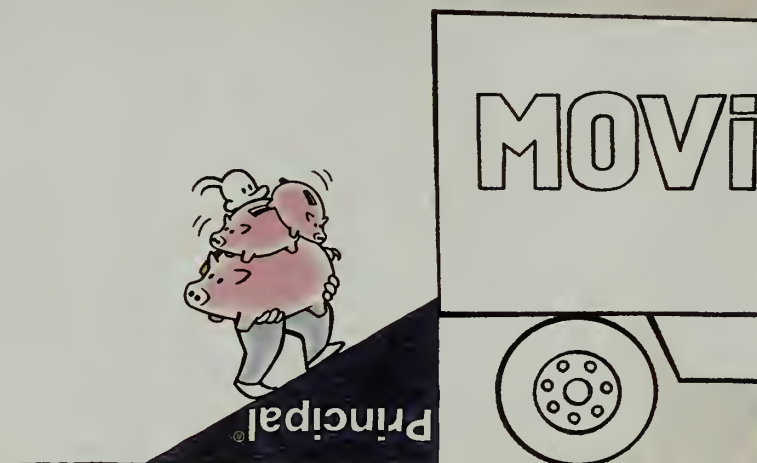
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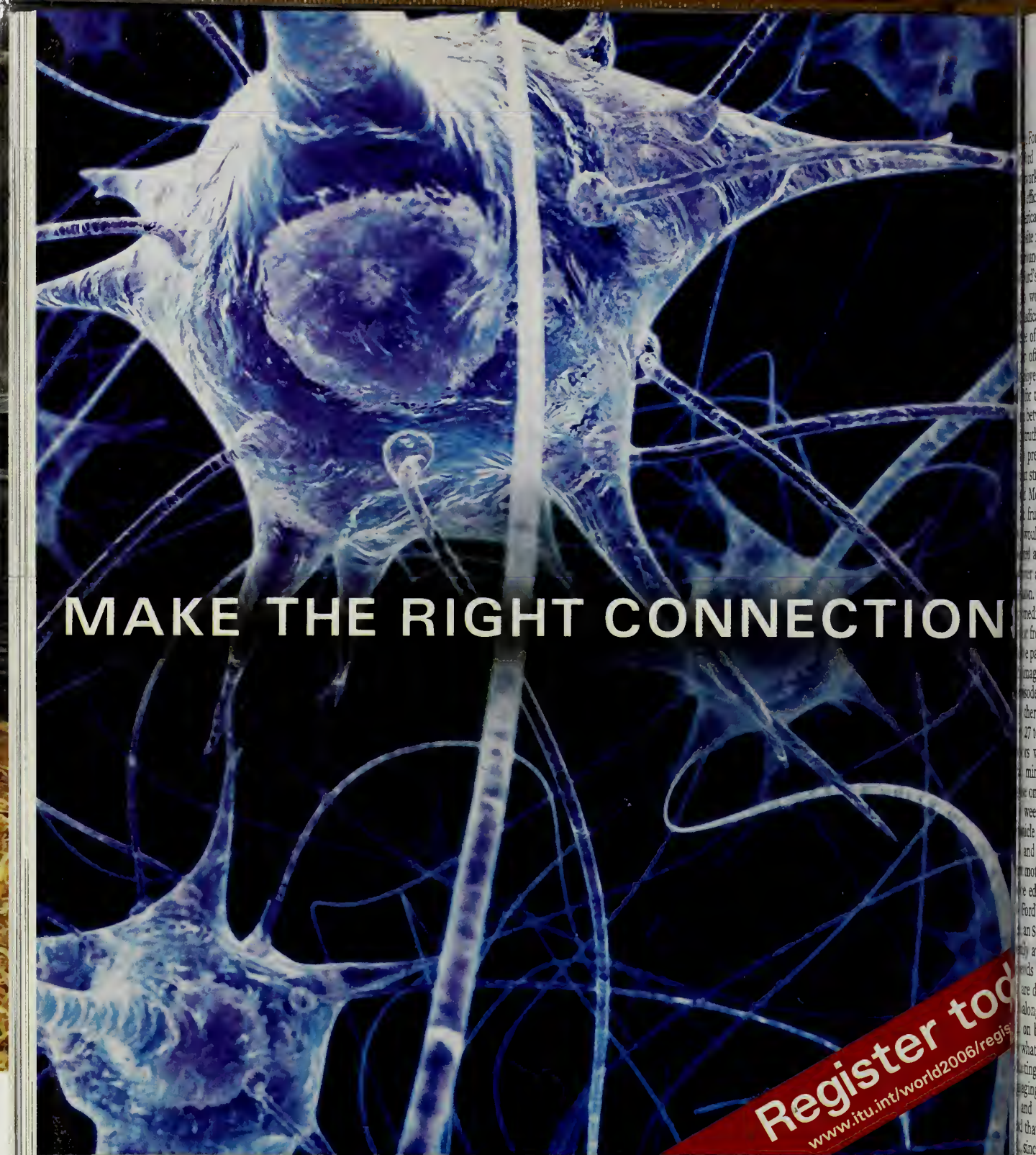


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Ford shares a sell rating. In another, Ford critic at the Rainforest Action Network states that "Ford has the worst efficiency record of any automaker in America." A journalist's article posted on the site refers to a management "merry-go-round" and "insipid products."

Ford's paying for this? Joe Berlinger, who works for the production firm Radical Media and who has directed some of the site's short films, says his team often has to convince suspicious employees that the film crew is working for the company. "There's real tension between promoting Ford's agenda and truthful storytelling," says Berlinger, who previously made a documentary about strained relationships in the rock band Metallica. Berlinger says he has been frustrated at times when higher-ups wouldn't grant him all the access he needed and when they nixed his attempt to stage a boycott by the American Family Association over the company's support for the media, a subject vetoed as straying far from the turnaround theme.

The payoff for Ford in a more engaging image is hard to measure. But the videos draw a lot of eyeballs. Ford had more than 1.2 million clicks from Oct. 27 to Oct. 15, with 856,000 unique visitors who stayed for an average of 10 minutes. The videos are available on blogs, 500 of which Ford monitors weekly. Several Webisodes simply chronicle the making of new Ford products and Ford recently bought ad space to promote these films on 400 blogs.

The edgier approach is spilling over into Ford's TV ads. An ad for the Freedom SUV-minivan crossover, features a family away for a weekend at the beach that ends with a surprise twist: The parents are divorced and Dad has been in a car along. The ad has been a polarizing force on blogs and in newspapers—exactly what Ford wants. Says independent marketing consultant Dennis Keene: "It's engaging consumers about your product and creating stories around your product that people talk about is a good thing, since most of Ford's marketing has been wallpaper."

Ford's commissioning of a mini-documentary about the Norfolk closure was something plant manager Joseph Lee would have expected, especially at a tense time. So he was a skeptic. But his part in the film had an unexpected twist: "Talking in front of the camera was therapeutic for me," says Lee.

Radical Media's Berlinger smiles when making that comment. "The guys in the film said the same thing." ■

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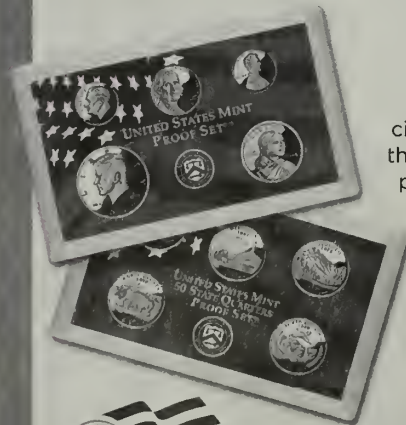
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## What Could Stoke The Bond Market

Electronic trading at NYSE Bonds should help demystify the complexities of bond trading

BY JOSEPH WEBER

**C**ORPORATE BONDS should be an ideal investment for baby boomers. They churn out predictable cash payouts, are generally more secure than stocks, and are rarely as volatile. But hidden dealer markups, a lack of real-time price information, and general complexity have scared off many retail investors. "It's always been a step-child market," says Donald G. Dueweke, former head of fixed-income trading at the New York Stock Exchange.

That may soon change. Electronic trading, which has goosed volume for stocks while making them cheaper to trade, will be coming to NYSE's bond-trading operation, NYSE Bonds, as early as November. Along with it will come real-time quotes and other information for a wide range of bonds issued by many of the 2,700 companies whose stocks trade on the NYSE. Investors who have had to rely on their broker's word for bond prices will soon be able to demand much of the same

data they now get on stocks. "We're looking to capture a lot more market share," says John M. Holman, who heads fixed-income trading for the exchange. There's no reason, he adds, that bonds can't be as popular as stocks.

Already, small investors can get more information than they used to. For the last few years, the TRACE system run by the NASD (formerly the National Association of Securities Dealers) has reported information on trades within 15 minutes of each sale, giving investors a taste of what's to come.

But the TRACE system isn't perfect. The quotes are often for bonds traded by institutions, which account for more than a third of transactions and about 95% of the dollar volume. These can be far from the prices that buyers of small lots get. What's more, hidden markups ratch-

et up the price, driving plenty of investors out of the bond market entirely. "Five times bitten and forget it," says Robyn Greene, a retired lawyer who lives near Jacksonville, Fla. She has dabbled in bonds for 30 years but now sticks to certificates of deposit.

### DAY TRADERS, BEWARE

ONCE A USER-FRIENDLY system in place, a few things must happen to lure people like Greene to take a look at bonds. One, bonds won't really take off until firms market them. That's why the NYSE is heartened that outfits such as E\*Trade Financial Corp. plan to beef up their bond offerings. By yearend, E\*Trade plans to disclose its fees and the commissions it pays instead of burying them in the offering price. "We're looking to provide more transparency," says Liat Rorer, E\*Trade senior director.

Such efforts should narrow the differences between bond and stock trading. For years, investor advocates say, but investors have been ripped off by Wall Street firms that secretly build in markups; thus the yawning spreads between the price investors pay and the price they get when they sell. "The public has been screwed in not having access to a market that has fair disclosure," argues John Siesel, a former Securities & Exchange Commission staffer who worked for the NYSE for years to press for a more open bond trading system.

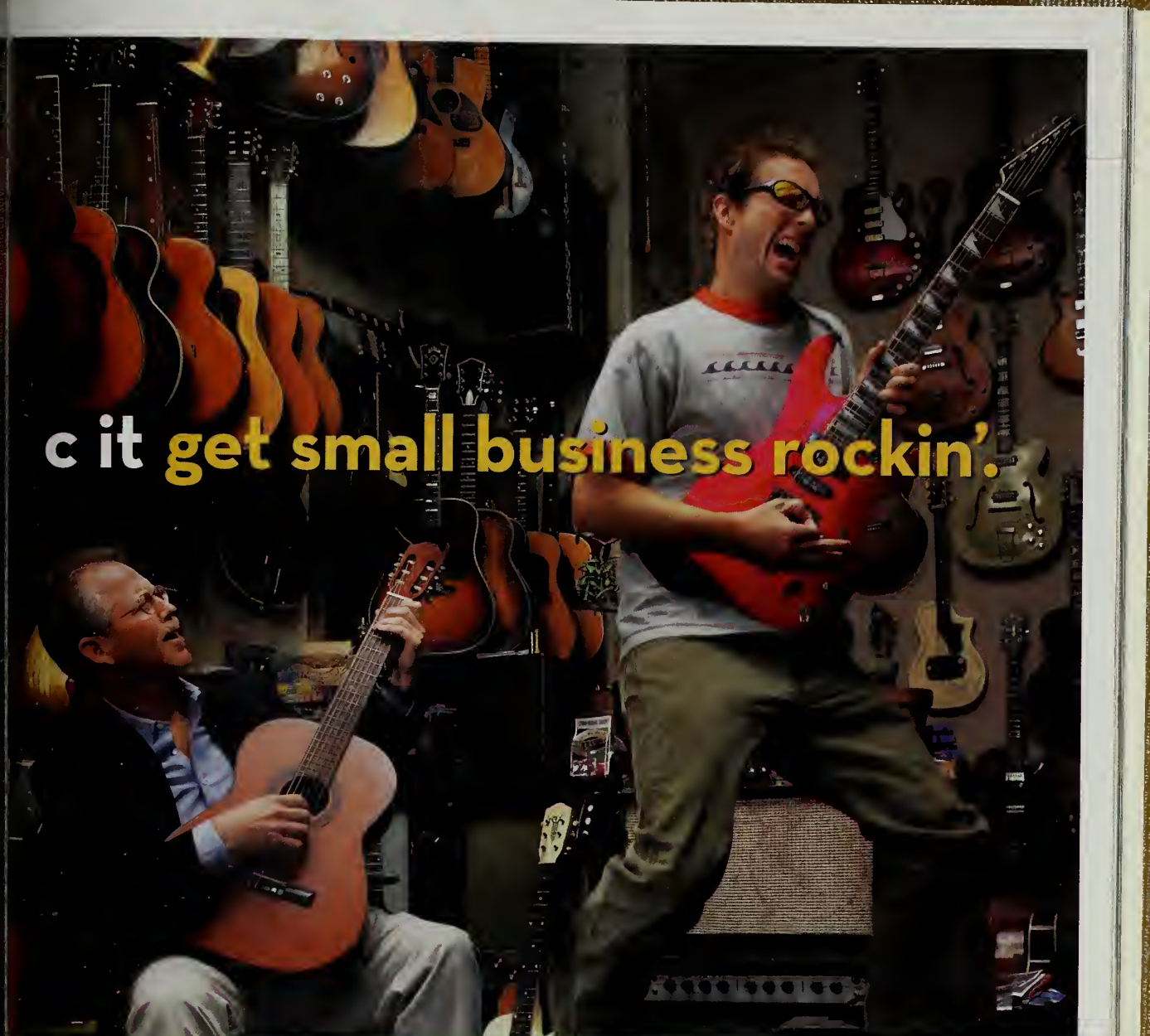
But most small investors have a lot to learn before they can start day trading bonds. Bonds differ radically from stocks: One company can call a bond back, returning cash to the investor but making planning tougher. What's more, prices rise and fall inversely to interest rates; bonds paying high rates command high prices when interest rates dip. On top of that, a company's shifting credit rating can make bonds worth more or less. And companies can issue scores of bonds with different maturities. There are 33

different issues right now, according to the NASD. "Give people so many choices, they can't make a choice," says Robert Knox, a senior vice president at Union Bank-based Zions Bank. You can bet that Wall Street will clear away any remaining confusion once it sees there's money to be made. ■

### ROOM FOR IMPROVEMENT





A photograph of a man and a woman in a music store. The man, on the left, is wearing glasses and a dark jacket over a light blue shirt, playing an acoustic guitar. The woman, on the right, is wearing sunglasses and a grey t-shirt, playing a red electric guitar. They are both smiling and appear to be enjoying themselves. The background is filled with various guitars hanging on the wall and on stands.

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# Like Father, Like Son At Qualcomm

As the lawsuits pile up, Paul Jacobs is proving every bit as feisty as the chipmaker's founder

**RONALD GROVER  
OLGA KHARIF**

IN COLLEGE, PAUL E. JACOBS would have been voted least likely to start a fight. Tall and thin, with an easy smile, he likes to tell the story of how he met his wife while choosing players for a pickup volleyball game, then packed the rest of the team "with guys who weren't all attractive."

But in the 16 months since Jacobs, 43, took over from his father, Irwin, as chief executive of chipmaker Qualcomm Inc., he has stirred up a hornets' nest. Lawsuits have piled up faster than silicon chips at an assembly plant. Cell-phone giant Nokia Corp. claims Qualcomm is using its 1,800 patents for wireless devices to extract outsized royalties on current and next-generation products. Chip rivals, led by Broadcom Corp., say

**TOLL KEEPER** Jacobs offers no apologies for the company's aggressive patent negotiations

they are being denied licenses to key technologies at reasonable rates.

Jacobs and Qualcomm appear to their detractors every bit the bullies in mobile phones that Bill Gates and Microsoft Corp. once seemed to PC software companies. The squabbles probably won't block any new Net-surfing, TV-viewing cell phones from reaching the hands of consumers. But they could shape the financial fortunes of numerous tech outfits, starting with Qualcomm.

More than two-thirds of the company's \$2.3 billion in operating earnings last year came from patent royalties. Worries about the court cases have helped push Qualcomm's stock price down by 23% since the spring, to 39. "There's more speculation that maybe Qualcomm isn't as invincible as it has been in the past," says Michael Mahoney, managing director of EGM Capital, who sold his Qualcomm shares earlier this year.

## A WORTHY HEIR

THE BATTLES ARE a chance for Jacobs, an engineer who got his PhD in robotics at the University of California at Berkeley, to prove himself a worthy heir to his 73-year-old father. Irwin Mark Jacobs, who founded Qualcomm in his den in 1985 and is still chairman, was known for his toughness—in the marketplace and in the courtroom. In the mid-'90s he pushed the patents for code-division multiple access (CDMA) technology—which made it easier for phones to send voice and data—with bruising lawsuits that included charging a Motorola Inc. scientist had stolen a prototype Qualcomm-made handset. The companies settled, and Motorola extended its licensing agreement. Today, Qualcomm's CDMA patents power an estimated 47% of U.S. cell phones, and payments for its patents make up about 5% of the wholesale cost of those handsets. "From Irwin's days, Qualcomm was a company that had to fight to get acceptance," says Dave Mock, author of the 2005 book *The Qualcomm Equation*. "And Paul learned from his dad."

This time around, though, it's Paul Jacobs and Qualcomm that are fending off rivals such as Broadcom, which has developed competing patents or cell-phone chipsets for phones that use the so-called universal mobile telephone standard (UMTS). Qualcomm's patents give it less of a controlling position in that newer





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## InfoTech Cell Phones

technology. Indeed, a recurring theme in the complaints is that Qualcomm uses its patents to claim a larger role—and higher royalties—in next-generation devices than its research efforts warrant.

Qualcomm is hardly a tech laggard. The great majority of the 9,300 people it employs in San Diego and around the world are engineers and researchers, and it spent \$1 billion last year on research into CDMA and other technology. Through its Flarion unit, Qualcomm is developing ways to provide wireless broadband service in competition with technology backed by Intel Corp., and it is creating an over-the-air TV service called MediaFLO that will provide live TV signals to cell phones.

Still, there's no denying that an oversized share of Qualcomm's success flows from the rights to such unexciting but necessary technologies as sending voice calls and connecting to the Internet using CDMA technology. For all the complaints, those technologies remain essential in next-generation phones as well. "Their patents are like the fourth wheel of a car. You could probably drive it without a key patent, but it would be a very bad ride," says economist and intellectual-property expert Christian M. Dippon, vice-president of National Economic Research Associates.

### HARDBALL TACTICS

JACOBS DOESN'T APOLOGIZE for playing toll keeper. He points out that for years, Qualcomm spent heavily to blaze the CDMA path that became wildly popular for phone carriers in the U.S. "I find it amazing that we're being sued by the No.1 handset maker, the No.1 chipset maker, and the No.1 and 2 guys in Japan," he says. "A lot of these are the same companies who [once] said our technology was worthless. And now they say they can't live without it."

What rankles cell-phone and chip companies are Qualcomm's hardball negotiating tactics. Earlier this year, industry sources say, Intel accused Qualcomm of packing a standards-setting board with Qualcomm-hired consultants in order to try to favor its own wireless broadband technology. Qualcomm concedes that it had consultants on the panel, including the panel chairman, but denies it used undue influence. Jacobs

claims the dustup reflects Intel's own interest in a competing technology. Still, June, without mentioning Qualcomm name, the Institute of Electrical & Electronics Engineers suspended its work creating a standard, citing "dominant and other irregularities."

Broadcom, whose chips appear in cable-TV set-top boxes, modems, and other devices, has lobbed suits contending that Qualcomm won't license patents needed for UMTS-powered phones with the "fair, reasonable, and nondiscriminatory" rates required by the industry's standard-setting bodies. Qualcomm disputes that, pointing to the many license agreements it has with other companies. "How much more fair and reasonable can you get than bilateral negotiations with the rest of the marketplace?" asks Qualcomm general counsel Louis M. Lupin.

Qualcomm returned fire, filing three suits against Broadcom, including one alleging that it misappropriated trade secrets. A during contentious negotiations last year to extend an existing license agreement with Nokia, Qualcomm filed patent-infringement suits against the handset maker. Nokia responded in August with its own suit, complaining to Delaware's Chancery Court that Qualcomm was "threatening to enjoin Nokia from manufacturing or selling products...unless Qualcomm's demand for unfair and unreasonable royalties is accepted." In an early October ruling, judge at the International Trade Commission found Qualcomm infringed one of three Broadcom patents, but didn't stop customers from importing phones containing its chips.

A far bigger threat may be shaping up in Europe. There, Broadcom, Texas Instruments, and others have urged the European Commission to investigate Qualcomm's practices. The charge, which the European Commission has yet to investigate formally, would be that Qualcomm before the same regulatory body that saddled Microsoft with nearly \$1 billion in fines and imposed new rules on the software giant. Jacobs rejects a comparison out of hand. "We're not Microsoft," he says. "Microsoft's failure is that they don't share their technology with anyone at any price. We, however, will sell our technology to anyone who wants it."

### THE STAT

# 69%

Share of  
Qualcomm's 2005  
operating income  
that came from  
patent licenses

Data: Qualcomm Inc.

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2 November 2006, Claridges, London

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# The Great CEO Exodus

An impatient Street and stepped-up oversight have CEO turnover in overdrive. Will business suffer?

BY NANETTE BYRNES

**W**HEN THE DOORS SLID open at the end of Tom Freston's final ride down the elevator at Viacom Inc.'s Times Square headquarters, it was to a lobby jammed with nearly 2,000 employees. They gave him a teary ovation, shouting "Tom! Tom! Tom!" A heartwarming show of support, all right, but love and admiration from the rank and file didn't prevent the 26-year veteran from getting fired three days earlier. Sumner M. Redstone, Viacom's chairman and largest shareholder, had been unhappy with the lagging stock

price and decided Freston wasn't moving fast enough to turn things around. Freston was in the job for just eight months.

His tenure may have been especially brief and the details of his ouster peculiar to his situation, but Freston's story is becoming all too familiar. Already this year, 1,112 chief executives have left the corner office, both voluntarily and not. CEO turnover, in fact, is on pace to exceed last year's record 1,322 exits, according to Chicago consulting firm Challenger, Gray & Christmas Inc. The departures so far in 2006 include the honchos of some of America's best-known companies: Ford Motor, Kraft Foods, Nike, Pfizer, Ra-

dioShack, UnitedHealth—the list goes

Yes, it's hard to feel sorry for CEOs when they take home at least 300 times what the average worker makes each year (Up Front, page 13). Certainly, many of those leaving are going for good reasons. Headline-grabbing exit packages can seem little more than a reward for failure. And the options backdating scandal churning around Silicon Valley (page 14) and elsewhere is often a testament to runaway greed. On Oct. 15, it claimed yet another head, that of United Health Care Executive Dr. William W. McGuire, plans to retire before Dec. 1.

Then again, intense global comp



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## Corner Office Casualties

Some prominent CEOs who are moving on or have been forced out this year



**WILLIAM MCGUIRE**  
United HealthCare  
Exit: By Dec. 1



**RICHARD THALHEIMER**  
Sharper Image  
Exit: Sept. 26



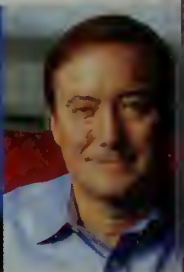
**WILLIAM C. FORD JR.\***  
Ford Motor  
Exit: Sept. 5



**TOM FRESTON**  
Viacom  
Exit: Sept. 5



**HENRY MCKINNEL\***  
Pfizer  
Exit: July 28



**ROGER DEROMEDI**  
Kraft Foods  
Exit: June 26

\*Remains chair

tion, a Street impatient for results, and regulators on the warpath are all contributing to corner office angst, too. CEOs feel understandably beleaguered, expecting the ax to fall any moment. "I'm always two quarters away from being a horse's ass," says Paul R. Charron, 64, CEO of Liz Claiborne Inc., who's stepping down in November after a strong 12-year run. "The market has a very short attention span. It's easier to criticize than to construct. You can get whacked in so many ways." And with the average CEO in the job just seven years today, almost two years less than two decades ago, some worry that short-term thinking is taking a toll. "Who will build the long-term future of these companies?" asks Yale School of Management professor Jeffrey A. Sonnenfeld.

The horse Liz Claiborne's board is betting on is William L. McComb. He's a 43-year-old powerhouse who has jumped from one business to the next, six in all, during a fast-track 14-year climb up the ranks at Johnson & Johnson. Coached by management guru Ram Charan, who compares his appetite for learning on the job to that of another client named Jack Welch, McComb has often had to get up and running on a new enterprise quickly.

### 100-DAY WINDOW

RUNNING LIZ CLAIBORNE may prove to be a challenge of another magnitude. Not so long ago, a new CEO like McComb would have had six to nine months to get his act together. Not any more. Management experts say the newly minted boss has about 90 to 100 days to start implementing strategy. For McComb, that's not much time to learn an unfamiliar industry, not to mention a company that operates in 80 countries and counts depart-

ment stores among both its biggest customers and toughest competitors. "These transitions are like jumping on a moving train," McComb says. He plans to spend much of his first months talking to staff, trying to win their loyalty, and teasing out of them how the company can best grow.

Like Liz Claiborne, more companies are looking outside for their next leader. Finding him or her isn't easy, despite all the talent floating around these days. Gerard R. Roche, senior chairman of leading recruiter Heidrick & Struggles, says it's getting harder to fill high-level openings as more candidates opt to work at private equity firms or run private companies. "We have to work harder than we used to," says Roche. "We used to think, 'tell us your need and we'll give you half a dozen candidates.' Now [those candidates] say, 'I've been talking to Blackstone and Kravis and I'm thinking about going private.'"

And even when companies find a suitable outsider, it's often not an ideal situation. Harvard Business School professor Rakesh Khurana says outside CEOs often focus on their most powerful constituencies—their board and investors—to the detriment of the businesses themselves. The instinct has become all the more prevalent with the rising clout of hedge funds, which are more than willing to share their views. "You now see a lot of CEOs who are not internally focused," says Khurana. "For them, the people in a company, what the company produces, the services it provides are abstractions."

And you know something smells when soon-to-be CEOs spend much of their contract negotiations focusing on their inevitable departure. "When put together a contract we are absolutely thinking about the end, the next job," says Wendi S. Lazar, counsel to Outt Golden LLP, a New York employment law firm that represents executives nationwide and elsewhere. "We're not getting paid to celebrate the wedding." Lazar's goal not only is to make sure that the client gets paid on departure, but what he would have earned had he stayed, but that I made whole for unvested options or restricted shares he left at the job, too. Lazar expects the Securities & Exchange Commission to push to limit exit pay on prompt CEO departures to mandate more pay up front to compensate.

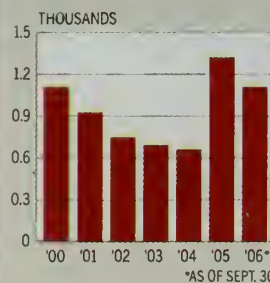
Hired guns, focused on short-term gains, may have

edge with Wall Street, but in-house candidates know a company's people. Like Freston, they often have their employees' backing. In researching his best-seller *Good To Great*, management guru Jim Collins found that of those companies whose stocks outperformed the competition over the long term, 90% had a homegrown CEO. Why did they do so well? Because they knew which people on staff were good and where best to deploy them.

Even so, Collins notes that most of these CEOs didn't get their programs humming until seven years into the

### REVOLVING DOOR

NUMBER OF  
CEO DEPARTURES



Data: Challenger, Gray & Christmas Inc.



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tenure, just when the average company boss today is walking out the door. "The best chance for spectacular results comes from insiders who have enough time to lay the foundation that will lead to them," says Collins. "If we're systematically lurching for saviors and shorting the amount of time a CEO gets, we're on a systematic path toward increased mediocrity."

Sometimes a chief really does need help. For nearly five years as Ford Motor Co.'s CEO and chairman, William C. Ford Jr. dealt with Wall Street, falling credit ratings, and market-share losses—all the while trying to overhaul the automaker's manufacturing, engineering, and labor relations. When it became clear that Ford would have to revise its profit target again from 2008 to 2009, says one top executive, "I

think he knew it was finally beyond him. Ford kept the chairmanship but he was as CEO Boeing Co. veteran Alan Mulally who was named on Sept. 5. Mulally long last has the CEO job he craved. Like every other corporate chieftain these days, he faces a ticking clock. ■

—With David Kiley in Detroit, Roger O. Crockett in Chicago, and Lowry and Jena McGregor in New York

## OPTIONS SCANDAL

# In the Valley, Scars that Could Last a Long Time

BY PETER BURROWS

In Silicon Valley, stock options are the coin of the realm, used to seal the deal with prized recruits and say "thanks" to executives for a boffo year. But lately options fever has a new meaning in the Valley. Not a day seems to pass without an announcement that a company has dug up options bookkeeping misdeeds and is firing top executives and restating financials.

So far, 18 executives, at companies such as online publisher CNET Networks and software maker McAfee Inc., have been ousted. Former executives at Apple Corp. and chipmaker Altera Corp. have been implicated. And the party is just getting started: Over 40 Valley companies face government scrutiny. "More and more companies are trying to work with the authorities and get out ahead of this," says Joe A. Grundfest, a former commissioner at the Securities & Exchange Commission who is now director of the Arthur and Toni Rembe Rock Center for Corporate Governance at Stanford University.

Yet even when the backdating wave recedes, it may leave long-lasting scars. This is the first time tech companies have faced such a broad-based threat of prosecution. On the plus side, boards are paying far closer attention to the details of corporate governance. Even minor transgressions that once might have been excused in the cause of doing business the fast-paced Valley way are no longer acceptable. But many techies worry that directors are spending more time staying out of trouble than finding the Next Big Thing. "The level of anxiety is way higher, and people are getting paranoid about everything," says Joseph B. Costello, a software vet who sits on three boards. "My fear is that Silicon Valley is like a beautiful racing yacht that has just



accumulated a big pile of barnacles... that will slow down the pace of innovation."

The purge began after news reports showed that many companies seemed to have cherry-picked dates when stock prices were low to grant options and ensure the biggest payoff—without reflecting these "in-the-money" grants as expenses, as required by accounting rules. When federal regulators and law enforcement agencies stepped in, many boards launched their own probes. Now, results in hand, they are rushing to crack down before the feds do it for them.

Once a special board committee is set up to investigate the books, companies are in many ways governed by outside experts who

step in. Executives may have to hand over their computer hard drives, while lawyers and forensic accountants search through crates of old paperwork and interview underlings. What starts out as an options probe can broaden if the hired experts come to doubt management's integrity in other areas. That happened at Mercury Interactive Corp., where Costello has been a director

since early this year. Mercury fired its former CEO and CFO after an investigation turned up 49 instances of backdating. The SEC is considering bringing charges against three long-standing directors. But Costello figures that more than two-thirds of the \$70 million spent on outside investigators went to make sure Mercury was properly booking its sales, paying commissions, and examining other non-options-related issues.

A complaint that's often heard, sotto voce, in the Valley is that the crackdown has tumbled out of proportion. Executives and experts alike note that most backdating was done by fast-growing young companies desperate to hire and retain top talent and lacking in the internal processes to properly account

for options granted below the stock price on a given day. "A lot of good companies are being run through the wringer," says the CEO of a company that restated earnings.

But others say that smacks of rationalization. Willem P. Roelandts, CEO of chipmaker Xilinx Inc., says he is dismayed by peers who argue they didn't realize backdating was illegal. "I'm sorry, but I don't buy that—because we knew it wasn't right, and we didn't do it." Xilinx spent a "few million" on an investigation this summer; it uncovered only small administrative problems, no fraud. Says Roelandts: "It was a waste of money, but we had to do it to clear our name."

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# Karma Capitalism

Times have changed since Gordon Gekko quoted Sun Tzu in the 1987 movie *Wall Street*. Has the *Bhagavad Gita* replaced *The Art of War* as the hip new ancient Eastern management text?

By Pete Engardio

**S**IGNS OF WORLDLY SUCCESS abounded as members of the Young Presidents' Organization met at a mansion in a tony New Jersey suburb. BMWs, Lexuses, and Mercedes-Benzes lined the manicured lawn. Waiters in starched shirts and bow ties passed out vegetarian canapés. And about 20 executives—heads of midsize outfits selling everything from custom audiovisual systems to personal grooming products—mingled poolside with their spouses on a late September evening.

After heading inside their host's sprawling hillside house—replete with glittering chandeliers, marble floors, and gilded rococo mirrors—the guests retreated to a basement room, shed their designer loafers and sandals, and sat in a semicircle on the carpet.

The speaker that evening was Swami Parthasarathy, one of India's best-selling authors on Vedanta, an ancient school of Hindu philosophy. With an entourage of disciples at his side, all dressed in flowing white garments known as *kurtas* and *dhotis*, the lanky 80-year-old scribbled the secrets to business success ("concentration, consistency, and cooperation") on an easel pad. The executives sat rapt. "You can't

succeed in business unless you develop the intellect, which controls the mind and body," the swami said in his mellow baritone.

At the Wharton School a few days earlier, Parthasarathy talked about managing stress. During the same trip, he counseled hedge fund managers and venture capitalists in Rye, N.Y., about balancing the compulsion to amass wealth with the desire for inner happiness. And during an auditorium lecture at Lehman Brothers Inc.'s Lower Manhattan headquarters, a young investment banker sought advice on dealing with nasty colleagues. Banish them from your mind, advised Parthasarathy. "You are the architect of your misfortune," he said. "You are the architect of your fortune."

The swami's whirlwind East Coast tour was just one small manifestation of a significant but sometimes quirky new trend: Big Business is embracing Indian philosophy. Suddenly, phrases from ancient Hindu texts such as the *Bhagavad Gita* are popping up in management tomes and on Web sites of consultants. Top business schools have introduced "self-mastery" classes that use Indian methods to help managers boost their leadership skills and find inner peace in lives dominated by work.

More important, Indian-born strate-

gists also are helping transform corporations. Academics and consultants such as C. K. Prahalad, Ram Charan, and Vijay Govindraj are among the world's hottest business gurus. About 10% of the professors at places such as Harvard Business School, Northwestern's Kellogg School of Business, and the University of Michigan's Ross School of Business are of Indian descent—a far higher percentage than other ethnic groups. "When senior executives come to Kellogg, Wharton, Harvard, or [Dartmouth's] Tuck, they are exposed to Indian values that are reflected in the way we think and communicate," says Dipak C. Jain, dean of the Kellogg School.

Indian theorists, of course, have a wide range of backgrounds and philosophies. But many of the most influential have knowledge that common themes pervade their work. One is the conviction that executives should be motivated by a broader purpose than money. Another is the belief that companies should take a more holistic approach to business—one that takes into account the needs of shareholders, employees, customers, society, and the environment. Some can even foretell the development of a management theory that replaces the shareholder-driven agenda with a more stakeholder-focus.







## Dueling Playbooks

The opposing best-practice ideas of Sun Tzu and Krishna

To Sun Tzu, author of the once-hip management treatise *The Art of War*, victory should be the "great object." Winning the battle is all about unyielding discipline. Some of Sun Tzu's key ideas:



The *Bhagavad Gita*, a Hindu text more in keeping with today's zeitgeist, contains the wisdom of Lord Krishna. Focus on your thoughts and actions, rather than the outcome. Krishna's take:

**GREED IS GOOD.** Troops have to see there is "advantage from defeating the enemy" in order to be motivated. Share the booty with the rank and file, and give them shares of conquered territory.

« ON FINANCIAL INCENTIVES »

**GREED IS BAD.** "You should never engage in action only for the desire of rewards," Krishna says. Acting on worldly desires leads to failure. Do well, and good things will come.

**BE TOUGH.** Sun Tzu calls for "iron discipline": If you indulge troops with too much kindness and don't maintain your authority, they'll be "useless for any practical purpose."

« ON MANAGING UNDERLINGS »

**BE FAIR.** Enlightened leaders are compassionate and selfless, and they "treat everyone as their equals. Followers will rally around them and follow their example."

**ATTACK ONLY WHEN VICTORY IS LIKELY.** Better yet, maneuver to win without a fight. If the odds are bad, retreat and wait for another opportunity. Long campaigns strain resources and make you vulnerable.

« ON INITIATIVE »

**ACT RATHER THAN REACT.** A leader's actions today can become the "karma" that influences his status tomorrow. Leaders accomplish "excellence by taking action," Krishna says.

**BEAT THE ENEMY.** War is a vital fact of life that "cannot be neglected by a responsible sovereign." Winning requires clever tactics and, in some cases, deception.

« ON THE ULTIMATE GOAL »

**SEEK HIGHER CONSCIOUSNESS.** Leaders should view problems within their larger contexts. Translation: Show sensitivity to multiple stakeholders including shareholders, employees, partners, and neighbors.

approach. "The best way to describe it is inclusive capitalism," says Prahalad, a consultant and University of Michigan professor who ranked third in a recent *Times* of London poll about the world's most influential business thinkers. "It's the idea that corporations can simultaneously create value and social justice."

You might also call it Karma Capitalism. For both organizations and individuals, it's a gentler, more empathetic ethos that resonates in the post-tech-bubble, post-Enron zeitgeist. These days, concepts such as "emotional intelligence" and "servant leadership" are in vogue. Where once corporate philanthropy was an obligation, these days it's fast becoming viewed as a competitive advantage for attracting and retaining top talent. Where the rallying cry in the 1980s and '90s may have been "greed is good," today it's becoming "green is good."

And while it used to be hip in management circles to quote from the sixth century B.C. Chinese classic *The Art of War*, the trendy ancient Eastern text today is the more introspective *Bhaga-*

*vad Gita*. Earlier this year, a manager at Sprint Nextel Corp. penned the inevitable how-to guide: *Bhagavad Gita on Effective Leadership*.



**T**HE ANCIENT SPIRITUAL wisdom of the *Bhagavad Gita* seems at first like an odd choice for guiding today's numbers-driven managers. Also known as *Song of the Divine One*, the work relates a conversation between the supreme deity Krishna and Arjuna, a warrior prince struggling with a moral crisis before a crucial battle. One key message is that enlightened leaders should master any impulses or emotions that cloud sound judgment. Good leaders are selfless, take initiative, and focus on their duty rather than obsessing over outcomes or financial gain. "The key point," says Ram Charan, a coach to CEOs such as General Electric Co.'s Jeffrey R. Immelt, "is to put purpose before self. This is absolutely applicable to corporate leadership today."

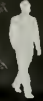
The seemingly ethereal world view

that's reflected in Indian philosophy surprisingly well attuned to the do-to-earth needs of companies trying to survive in an increasingly global, interconnected business ecosystem. Where corporations used to do most of the manufacturing, product development and administrative work in-house, emphasis is now on using outside Terms such as "extended enterprise" (companies that outsource many functions), "innovation networks" (collaborative research and development programs), and "co-creation" (designing goods and services with input from consumers) are the rage.

Indian-born thinkers didn't invent these concepts, but they're playing a role in pushing them much further. Prahalad, for example, has made a splash with books on how companies can create products with consumers and succeed by tailoring products and technologies to the poor. That idea has influenced companies from Nokia Corp. to Cargill. Harvard Business School associate professor Rakesh Khurana, who achieved acclaim with a treatise on how corpo-





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tions have gone wrong chasing charismatic CEOs, is writing a book on how U.S. business schools have gotten away from their original social charters.

Vijay Govindarajan, a professor at Dartmouth College's Tuck School of Business whose books and consulting for the likes of Chevron and Deere & Co. have made him a sought-after innovation guru, links his theories directly to Hindu philosophy. He helps companies figure out how to stop reacting to the past and start creating their own futures through innovation. Govindarajan says his work is inspired by the concept of karma, which holds that future lives are partly determined by current actions.

## The Young Presidents' Organization in New Jersey soaks up the philosophy of Swami Parthasarathy

"Karma is a principle of action. Innovation is about creating change, not reacting to change," he says.

There are also parallels between Indian philosophy and contemporary marketing theory, which has shifted away from manipulating consumers to collaborating with them. "Marketing has tended to use the language of conquest," says Kellogg professor Mohanbir S. Sawhney,

a Sikh who discusses the relevance of *Bhagavad Gita* to business on his Web site. Now the focus is on using customer input to dream up new products, Sawhney says, which "requires a symbiotic relationship with those around us."

Kellogg's Jain, who is working on a book about the customer-centric business models of Indian companies, believes that many Indian thinkers are drawn to fields stressing interconnectedness for good reason. "We have picked areas that are consistent with our passion," he says.

Whatever the common themes, India, of course, is hardly a showcase of social consciousness. While co-



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\*Average effect depending on dose

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*Please see additional important information on next page.*

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LPIF Rev 2, Dec 2005

es such as Tata Group or Wipro technologies have generous initiatives for India's poor, the country has a share of unethical business practices and social injustices. In addition, some Indian academics bristle at suggestion that their background defines their approach to business any more than their ethnicity. They're quick to point out a wide range of religions, influences, and specialties among them.

Indeed, it's not surprising that thinkers from a country with as diverse an economic and social makeup as India would have different perspectives on the influences on business work. "We are a fusion society," says Ashwini Khurana. As a result, many Indian management theorists "tend to look at organizations as complex social systems, where culture and reciprocity are important," he says. "You won't hear too many of them say the only legitimate stakeholders in a company are stockholders." What's more, the extreme poverty imposes a natural barrier on its companies to contribute to the common good.

Indian thinkers are affecting not only how managers run companies. They are also furthering their search for personal fulfillment. Northwestern's Kellogg even offers an executive education leadership course by Deepak Chopra, a controversial self-help guru and spiritual healer to the stars. Chopra is on the board of clothing retailer American Apparel Inc. and has conducted programs for Deloitte, Harvard Business School, and the World Bank. In a stark, brightly lit classroom, Chopra, wearing glasses with heavy black frames studded with rhinestones, led a group through a 20-minute meditation in which he said, "Sit comfortably in your chair with your feet planted on the ground," Chopra attracted the 35 mostly midlevel executives from corporations that are as far as ABN Amro Bank and sporting goods retailer Cabela's Inc. "Our mantra is: 'I am.'"

**OTHER B-SCHOOLS ARE** adding courses that combine ancient wisdom with the needs of modern managers. A popular class at both Columbia Business School and London Business School is "Spirituality & Personal Mastery," taught by Columbia's Srikumar Rao. Many attendees are fast-track managers who are highly successful at work but still miserable, says Rao. His lectures, which include mental exercises and quotes from Indian swamis and philosophers, win praise from man-

## The Dharma Dons

A few of today's most prominent management thinkers of Indian descent:

### RAM CHARAN

CEO Coach, former professor, Harvard

»Among the world's most sought-after CEO advisers, Charan has worked closely with executives at General Electric and DuPont. The key point of the *Bhagavad Gita*, Charan says, is for leaders to "put purpose before self."



### VIJAY GOVINDARAJAN

Professor, Dartmouth College's Tuck School of Business

»Helps companies such as Corning and Johnson & Johnson build innovation strategies. He sees "karma"—the fate people determine by their actions—as relevant to leaders. "Destiny is not preordained. You can create your future."

### DIPAK JAIN

Dean, Kellogg School of Business

»At Kellogg, has brought in self-help gurus like Deepak Chopra for executive programs and added courses on ethics and social responsibility. Jain, a director of John Deere and Northern Trust, says Indian thinkers are helping to "create the globally conscious business leader of the future."



### RAKESH KHURANA

Associate professor, Harvard Business School

»Wrote *Searching for a Corporate Savior* in 2002, which questioned the hunt for charismatic, celebrity CEOs. Coming from a traditional society with many ethnic groups, says Khurana, helps one realize "no social order can be sustained if benefits go to only a few."

### C. K. PRAHALAD

Professor, University of Michigan

»With *The Fortune at the Bottom of the Pyramid*, Prahalad transformed companies' approach to the developing world. "The ultimate challenge is to create capitalism that puts individuals at the center of the universe," he says.



agers such as Goldman Sachs Group Inc. Managing Director Mark R. Tercek. "Business schools ought to be championing this stuff," says Tercek, a yoga practitioner. "We can hire the smartest damn people in the world, but many of them ultimately don't succeed because they can't motivate and work with those around them. I think the Indians are on to something."

They may be on to quite a lot. Some Indian theorists have said their ultimate goal is to promote an entirely different theory of management—one that would replace shareholder capitalism with stakeholder capitalism. The late Sumantra Ghoshal was attempting to do just that. At the time he died, the prolific London Business School professor was working on a book to be called *A Good Theory of Management*.

As Ghoshal saw it, the corporate debacles of a few years ago were the inevitable outgrowth of theories developed by economists and absorbed at business schools. Corporations are

not merely profit machines reacting to market forces; they are run by and for humans, and have a symbiotic relationship with the world around them. "There is no inherent conflict between the economic well-being of companies and their serving as a force for good in societies," wrote Ghoshal.

In their own ways, other Indian thinkers are picking up the mantle. Khurana's forthcoming book, *From Higher Aims to Hired Hands*, looks at the professional responsibility to society that managers and the business schools who train them were initially designed to have.

The quest, says Prahalad, is to develop a capitalism that "puts the individual at the center of the universe," placing employees and customers first so that they can benefit shareholders. This is a lofty if improbable goal. But if it is attained, business leaders may find that India's biggest impact on the global economy may be on the way executives think. ■

—With Jena McGregor in New York



# How This Tiger Got Its Roar

*In **Bangalore Tiger**, author Steve Hamm examines the rise of India as a destabilizing force in the \$650 billion worldwide tech services industry. He focuses on Wipro Ltd., one of the most successful of the Indian upstarts from Bangalore, and on its remarkable leader, Azim Premji. This excerpt chronicles how Premji transformed a peanut oil company in poverty-ridden India into a tech powerhouse.*

**I**T WAS THE KIND OF CALL THAT makes a young man grow up fast. On Aug. 11, 1966, Azim H. Premji was a senior at Stanford University in Palo Alto, Calif., studying for finals after summer school. When the phone rang, his mother was on the line from India with devastating news: His father, M.H. Premji, had died of a heart attack at the age of 51. The younger Premji quickly booked a flight and left for the funeral, expecting to be back at Stanford in time for the fall semester. Instead, his father's death marked a fateful change of direction for the 21-year-old. Rather than pursuing his dream of bringing aid to the developing world as a policymaker at the World Bank, he found himself thrust into the nitty-gritty details of saving a failing company in a backwater economy.

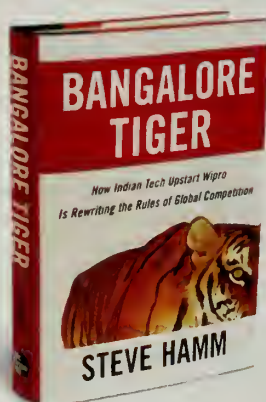
Fortunately, entrepreneurship runs in his blood. Premji's grandfather was founder of one of the largest rice-trading companies in India. Then, in 1945, M.H. Premji launched a cooking oil company called Western India Vegetable Products. But when the young Azim Premji arrived home he found the operation in shambles. And to his dismay, he discovered that his father had selected him to run it, a duty he felt he couldn't shirk. "It's like being thrown into a swimming pool," says Premji, who finally got his Stanford degree six years ago. "To avoid drowning, you learn to swim quickly."

Since his plunge into the deep end of commerce, Premji built the company, later renamed Wipro Ltd., into one of India's tech services powerhouses. Today the business provides software programming, engineering design, and back-office services for more than 500 of the world's largest corporations. One of the keys to Wipro's early success was its ability

to tap into India's vast pool of young technology graduates willing to work for wages as much as one-third lower than those in the West. But labor arbitrage is only part of the story. Wipro and other leading Indian tech outfits have learned to deliver quality work, top-notch customer service, and efficient human resources, and, increasingly, technology innovation. Once considered under-schooled upstarts, Wipro and its Indian counterparts have become innovators in doing business in a networked world.

When Premji took over his father's business, it was anything but global. It had about 350 employees, mostly in and around Bombay, and \$3 million in revenues. The company was locally traded, and not long after Premji assumed

control he faced shareholders for the first time at the annual meeting. Premji, who was self-conscious about his age and grown a mustache in an effort to add some gravitas. But less investors weren't impressed. One stood up to comment about the stock's lousy performance and demanded that Premji sell the company. "There's no way a twit like you can



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it," Premji recalls him saying. "More than anything else, that made me determined to prove him wrong," says Premji.

It was time for a crash course in capitalism. Premji had never taken a business class, nor had his father taught him anything about running the company. So he visited a professor at a leading management school in Bombay and asked him to recommend some textbooks. He bought a pile of them, and over the next year he stayed up late into the night reading every one. From his readings he learned business basics and systematically built a company based on modern principles and practices. Those early years taught him the necessity of continuous improvement. "You were constantly questing for excellence," he says.

The company's mainstay was buying peanuts from farmers and crushing them to produce shortening and edible cakes. The key employees were the buyers, who would evaluate a farmer's harvest by tasting the peanuts to make an estimate of the oil they contained and then set a price. Premji improved that system by asking farmers to send in samples that the company could dry and weigh to calculate the oil content. He transformed what had been an art into a precise business process, and he established Wipro's practice of routinely measuring every aspect of its business.

**P**REMIJI ALSO took an uncompromising stand on ethics. In the late 1960s and early '70s corruption was rampant in India, with government officials demanding handouts, customers asking for kickbacks, and farmers bribing clerks to tamper with weighing machines. Premji decided that his company had to be held to a higher standard, which he believed would ultimately enhance its stature with customers and employees.

Once the cooking oil business was back on track, Premji broadened his horizons. He had no grand vision of what Wipro could become, but he saw opportunities and didn't want to miss out on them. He diversified, first into soaps and beauty products, then venturing even farther afield by manufacturing hydraulic components for construction equipment. The next step: computers. After the Indian government passed new rules in the late 1970s that required foreign companies to operate through Indian-owned affiliates, IBM pulled the plug on its operations. "When IBM left, it created a vacuum," says Premji. "So we decided to zero in on info tech."

Premji and his lieutenants knew nothing about computers, but that didn't stop them from trying to make them. They rented a 4,000-square-foot office in Bangalore, home to several of India's top technical and management colleges, and decided to build a minicomputer that would sell for far less than an IBM

mainframe but do similar work. Within a year, Wipro shipped its first one. It later got into the PC business and quickly came the leading computer company in India.

But the good times weren't to last. In the early 1990s, India liberalized its economy. With rules relaxed, including the local partner requirement, the world's top tech companies flooded into the country. Wipro faced a crisis. Premji believed there was no way the outfit could beat Compaq, Hewlett-Packard and IBM in the PC business. The big brands had huge sales and vast research and development budgets, allowing them to underprice and outengineer Wipro and the other home-grown Indian PC outfits.

What Wipro did next set the stage for its emergence as a tech services powerhouse. The rescue plan was to sell engineering expertise to the world's top technology companies.

"We saw that while the door was open for others to come into India, it was also open for us to go out. We decided to become a global company," says Sridhar Madhavan, Wipro's longtime chief technology officer, who later left to found Infosys Inc., a rival tech services company. The first aim was designing software for telecom gear, but Wipro quickly followed with hardware and chip design. Its leaders believed they could set up similar operations and sell their services to a wide range of Western corporations—not just technology companies but also banks, manufacturers, and retailers.

Were the giants of Western capitalism ready to hire a tiny, nameless Indian outfit to perform important brainwork? Not so quickly. So Premji decided Wipro needed to do something to build its credibility. The solution: Focus on quality. In 1995, Wipro received certification from the International Organization for Standardization for manufacturing quality. Then it adopted the programming standards of Carnegie Mellon University's Software

Engineering Institute. In later years, Wipro was quick to implement Motorola Inc.'s Six Sigma quality program. And to its busy applying Toyota Motor Corp.'s lean manufacturing techniques to its software programming and business process outsourcing operations worldwide.

Practically every move Wipro made turned into an up-and-down battle. Subroto Bagchi, the longtime Wipro executive who is now chief operating officer at MindTree Consulting, remembers what it was like to gain a foothold in Silicon Valley. He moved his wife and two daughters to a two-bedroom apartment in Cupertino and set up an office in the dining room. He bought a PC and a fax machine at Price Club using a friend's credit card and immediately began churning out proposals as quickly as his fingers could type. His children would be waiting cartoons in the next room, but when they heard the phone ringing, they knew to put the TV volume on mute so Dad could



**THE CHAIRMAN IS NOT KING** Premji owns a controlling stake in Wipro but shares authority and responsibility with subordinates

*Continued on page 94*

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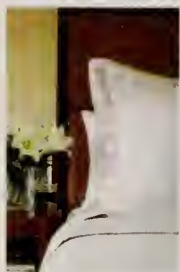
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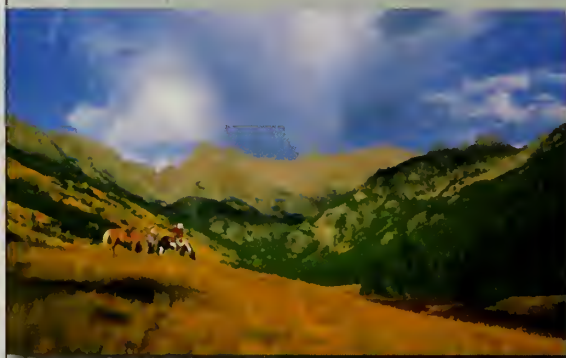
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*The Second-Home Edition*

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Second homes: they're where you want them, furnished to your impeccable taste, and available to you, family, and friends whenever you want. Problem is, if you're like most vacation-home owners, you escape to your getaway only three to five weeks annually. But the mortgage, taxes, and insurance? You're billed for the full year.



Now when you're in for a dime, you're not in for the whole dollar. The travel and real estate industries have overhauled the concept of second-home ownership by creating private residence clubs and destination clubs. By spreading the cost of second homes over multiple owners, these variations on a theme enable consumers to pay

for vacation homes only to the extent they use them. Club members pay one-time fees that are a fraction of the price of a year-round second home, and maintenance costs are also tiny by comparison.

## OWNING A PIECE OF PARADISE

Private residence clubs (PRCs), also known as fractional-ownership resorts, are for people who prefer going to the same place every year. Participants in PRCs purchase a fraction of the year, between 1/26<sup>th</sup> (one week) to one quarter (13 weeks), with a proportional, one-time membership fee and annual maintenance fee. They receive a deed, which can be sold or bequeathed. A PRC's use plan determines when and how owners can enjoy the resort. Most limit the number of consecutive weeks of use and dictate how far in advance owners can reserve.

With some fractionals, owners' weeks float, they're not guaranteed the same weeks every year, and they typically don't stay in the same unit each visit. In other clubs, like Vail Plaza Hotel & Club, set to open in early 2007, owners purchase specific weeks in specific residences. Says Eric Lyon, sales director for Vail Plaza: "We have 38 unique residences, so your view never changes, and your time never changes based on your first selection." The club's fractional residences have sold for \$200,000 to \$1.5 million. A nearby 1,700-square-foot private home lists at \$5 million.

## WHEN ONE SECOND HOME WON'T DO

"Many of Ultimate Resort's destination club members are former vacation home owners, like I was," says Jim Tousignant, CEO of Ultimate Resort. "The high cost and hassles of maintaining a second home, and the





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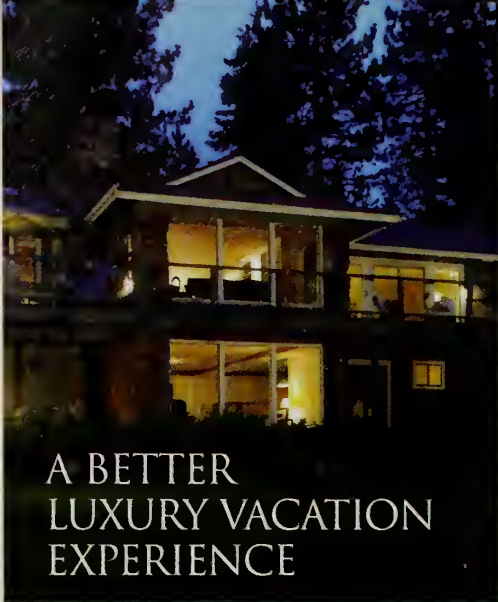


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*The Second-Home Edition*



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LUXURY DESTINATION CLUBS

limitation of always visiting the same vacation spot, strongly encourage them to look for a better, more affordable luxury vacation experience.

To banish boredom, Tousignant created Ultimate Resort, whose members can select from dozens of luxury residences (each valued roughly \$2 million) in resort destinations throughout the U.S., Mexico, the Caribbean, and Europe. These three- to five-bedroom homes come complete with five-star concierge, housekeeping services, and the amenities of country-club memberships.

When members arrive at Ultimate Resort club homes in resort communities such as Los Cabos, Mexico, or Lake Tahoe, the kitchen is already stocked, a wine cellar is filled with favorite vintages, and all member and guest reservations—from tee times and ski rentals to theatre tickets and restaurants—have already been coordinated requested before arrival.

Members pay a refundable, one-time membership fee plus annual dues. They can redeem their membership and receive 80% of the current membership fee, which would enable them to participate in the appreciation of the club. Members also receive a "warranty," which ensures services are available to them and places real-estate assets in a member trust.

### LA CRÈME DE LA CRÈME

To meet the standards of their wealthy clientele, fractional-residence developers choose exclusive enclaves within each resort—for instance, Miraval in Tucson, Bachelor Gulch in Beaver Creek, the Raffles Resort on Canouan Island, and Vail Village. PRCs and destination clubs pay enormous attention to creating upscale environments and offer many of the amenities of a luxury resort, from on-site concierges and spas to golf club memberships, boat slips, and hiking, biking, and ski trails.

### PLANNING YOUR FRACTIONAL STRATEGY

Sherman D. Potvin, a consultant to fractional developers and co-founder of [LuxuryFractionalGuide.com](http://LuxuryFractionalGuide.com), recommends comparing the use plans of private residence clubs you're considering. Does the fraction fit your time limitations? Can you reserve the same weeks annually? Are they fixed or rotating? Is the club within reasonable driving distance to take advantage of space available?

In addition, says industry expert Greg Shove, CEO of the online consumer guide "Helium Report," the right club must be able to demonstrate annually, with independent third-party verification, sufficient net assets to pay back membership deposits to all departing members at any time, whether today or in 10 years.

Once you're satisfied on all counts, you could find yourself owning a fabulous fractional vacation home, at less cost and with fewer responsibilities than you ever imagined. That calls for a split of champagne.

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pick up the telephone receiver and say: "Wipro Technologies."

As the company's first salespeople spread out across the U.S. in search of customers, they were like nomads. They got leads from technical people—often other Indians—who they knew in companies such as Intel, Seagate, and Sun Microsystems. Arriving in a new city, they'd camp out in a cheap motel and thumb through the telephone book looking for potential customers. "Nobody had heard of us," says Sudip Banerjee, president of Wipro's Enterprise Solutions business unit. "We'd make dozens of phone calls. Nobody would return them."

Wipro's big breakthrough came with General Electric Co. In 1990 the two companies had set up a joint venture, Wipro GE Medical Systems, to make and sell medical equipment in India. So GE was familiar with Wipro when it decided to shift some of its software development to the country. The entire Wipro management team, including Premji, pitched in to woo the Americans. "It was a large piece of business and gave us credibility," says Banerjee.

Twice in a little more than a decade, Wipro spotted fundamental shifts in the business environment and then scrambled to create new businesses. Today the company is doubling down on its bet on engineering services, which already represent 35% of its \$2.4 billion in revenues. In the past 12 months it has spent \$100 million to purchase three engineering design firms in the U.S. and Europe. "We're able to evaluate opportunities at the right time and put together an act to make a commercial success of it," says Premji.

One of Premji's most important accomplishments has been creating a sinewy management culture that thrives even under intense competitive pressure. He established two core principles that are instrumental in building the character of his leadership team. The first is rare among India's family-controlled companies: The chairman is not king. While Premji owns a controlling stake in Wipro, he shares authority and responsibility with his subordinates. The second key principle: Premji believes in a zero-politics culture. At Wipro, backstabbing, playing favorites, and kissing up to the boss—tactics that sap much of American executives' energy—simply don't work. Open and honest disagreements are not only tolerated, but also required—of everyone.

**T**HE CHAIRMAN'S STYLE ISN'T just to encourage his lieutenants to debate one another: Premji insists that they debate him as well—or even take him to task for his decisions or actions. "The man takes frontal criticism, and it's celebrated. You can openly disagree with him," says Bagchi, the former Wipro executive who launched Wipro's U.S. business from his dining room table. He recalls a time in the early 1990s when he was in

charge of the company's quality initiatives and Premji asked him to also handle office-building projects. V. Bagchi was slow to get something done, Premji called him home one afternoon as he was having tea with his mother. Bagchi resented Premji piling more on his plate. "What have to do with real estate?" I told him: 'Don't expect me to do your clerical jobs for you!' I actually screamed at him the phone," Bagchi recalls. Bagchi's mother was appalled by the outburst and, after the call ended, lectured him about showing proper respect to the boss.

The maternal tongue-lashing made Bagchi worry that he might have crossed the line. Would Premji be furious with him? Yet back in the office a couple of hours later, he ran into Premji in the hallway, and the chairman didn't even mention the episode. By Premji's rules of conduct, Bagchi's reaction had been just fine. Bagchi was relieved to know exactly how he felt. "He would tell us: 'Move on. It's time to push you. When you reach your limit you need to come back,'" recalls Bagchi.

For Premji, openness is more than a personal style. It's a strategy. "I find that people excel when they're provided a fair, free, apolitical environment," he says. "At Wipro we strive to provide an open culture that encourages diversity of opinions. An organization's ability to encourage and harness diversity of thought is a significant competitive advantage."

Playing the game of business according to Premji's rules has worked well for Wipro. Its revenues have grown consistently some 30% annually, while the overall tech services industry is expanding at about 5% per year. Meanwhile, operating margins in its tech business top 20%—more than twice the level of large Western services outfits.

Think of Wipro's success as a wake-up call for Americans who are complacent about the future of their companies or their job security.

With its work ethic and intense drive to win, Wipro is a reminder of the America of 100 years ago. "Are we hungry enough?" asks Nicholas M. Donofrio, executive vice-president for innovation and technology at IBM. Donofrio's father was an Italian immigrant who worked three jobs to support his family in the gritty factory town of Beacon, N.Y. Now, Donofrio asks whether Americans still possess that kind of drive. "If we amble along and take our time, the Indians and Chinese will close the gap and perhaps even surpass us. You can see the passion in their eyes. They're people on a mission."

The challenge is the same for American individual companies: If they mean to succeed in a world of borderless commerce, they will learn to be as relentlessly self-improving as Premji and Wipro. ■

*Steve Hamm is a senior writer at BusinessWeek. Bangor Tiger, published by McGraw-Hill, is his first book.*



**THE EARLY DAYS** The young man derided as a "twit" built a strong management culture that thrives on intense competitive pressure



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# Before You Splurge on the Latest Gear...

We sifted through this year's crop of flat-panel TVs, game systems, wire music, and more to find the category killers

ORLANDO HOETZEL





**T**he mantra for the consumer electronics industry sounds a lot like Hollywood's lingo for movie franchises: Bigger, better, more explosive than ever before.

This year is no exception, as manufacturers whet consumers' appetite for all things digital with giant new flat-panel TVs and everything else that goes into your dream home entertainment room.

Deciding what to buy can be daunting. That's where our technology buyer's guide comes in. Over the past few months, we've dived into the world of high-definition sets (page 104) and furniture that shows off—or hides—that big, big screen (page 108). Naturally, you'll want a high-definition DVD player, too (page 110). We got our hands on new game consoles and worked up a sweat with Nintendo's Wii, Sony's PlayStation 3, and Microsoft's Xbox 360 (page 114).

For music, we checked out wireless systems that can soothe the soul in one room, while letting you rock to the beat in another (page 112). So sit back and relax as we showcase our picks for must-have home entertainment gear.



# TV: It's a Flat World, After All



**50 INCHES AND UP**  
Sharp's Aquos 52-in. LCD LC-52D62U (\$4,700, left) is one of our top picks. It boasts crisp detail and reduced motion blur. Another is Panasonic's 65-in. plasma TH65PX600U (\$8,500), which has excellent overall color reproduction. Also strong is Pioneer's 50-in. plasma PDP5070HD (\$3,000) for its great connectivity options

## 40 INCHES AND UNDER

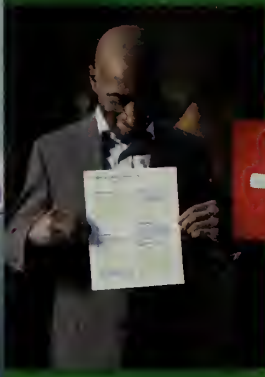
Our picks include Samsung's LCD LN-S4096D (\$3,000, right). This is a pricey one, but it has dazzling detail and strong sound. We also recommend the Dell W3707C (\$1,799). It can't handle the highest high-def format, but its picture is impressive



**DIVING INTO THE WORLD** of big TV can be a daunting prospect, but we've been doing your homework. Over the past few months we've checked out close to 100 models in all sizes and shapes, from the diminutive, 20-inch Humax liquid-crystal-display TV with DirecTV built in (\$700) to a 103-inch Panasonic plasma—a \$50,000 beast so big that installers have to come to your home to measure the doorway and room to see if it will fit and test the floor to determine if it can handle the 475-pound weight. (The TV prices quoted are typical retail prices, not manufacturers' suggested prices.) There's something for everyone. We've looked at plasmas from Hitachi, Panasonic, and Pioneer, as well as LCD sets from Dell, Sharp, Samsung, Sony, and Toshiba. We've checked out projectors and rear-projection sets from Hewlett-Packard, Mitsubishi, Epson, and ViewSonic.

The good news is that manufacturers are so intent on throttling one another that prices are falling sharply even as the technology in each set improves. The "sweet spot" for set sizes has edged up to 37- and 42-inch plasma and LCD models, such as Samsung's LN-S496D LCD and Sony's 40-inch XBR Bravia. That's where you get the most TV for the money. But buyers often think bigger. Many current HDTV owners are sorry they didn't buy a bigger set—as in 50 inches or more. The chief consideration in supersizing

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**42 TO 49 INCHES**  
Our favorites start with Sony's 46-in. LCD KDL-46XBR2 (\$3,400, above), with its array of high-def input choices. Toshiba's Regza 47-in. LCD 47LX196 (\$3,600) can be hooked up to a PC. On the value front, LG's 42-in. LCD 42LC2D (\$1,900) smooths out grainy analog pictures

your set is whether owning a high-definition DVD player is in your future (page 110), since those players look best on really big screens. The fine print there? You'll need a set labeled "FULL HD 1080." That means it offers 1080 progressive resolution, which is what makes high-definition DVD players shine.

We were blown away by the overall quality of most of the big-name brands. They deliver deeper blacks, brighter colors, and more detail than ever before. Many now throw in technology to "upscale" grainy analog broadcast television, and they help you take full advantage of the increasing wealth of HD sources by including loads of inputs for your HD TiVo, cable, and satellite boxes.

With the competition stepping up a notch, it was a tough call choosing our favorite set—until we feasted our eyes on Sharp's 52-inch Aquos LC-52D62U. The long-overdue redesign of the \$4,700 LCD set looks great, and the TV delivers one of the brightest, crispest, and most colorful pictures we've seen in all kinds of lighting. If that doesn't suit your fancy, take a gander at our other picks after reading the cheat sheet below for choosing the perfect centerpiece for your home theater.

—By Cliff Edwards

## The Skinny on Thin TVs

A Cheat Sheet for Snaring the Perfect Set

### PLASMA

**The Good:** Typically lower-priced than its main competition, LCDs, at the large end of the screen-size range; bright, with vivid colors and deep blacks.

**The Bad:** Prone to "ghosting" during action scenes and burn-in of static images when they're left on the screen too long; colors wash out in bright rooms.

**The Bottom Line:** Best used in dark rooms and a better value at sizes above 50 inches.

### LIQUID CRYSTAL DISPLAY

**The Good:** Displays all high-definition formats, including 1080 progressive, in all

screen sizes; looks better in brighter rooms; more energy-efficient than most plasma sets.

**The Bad:** Picture blurs in sports and fast-moving scenes; blacks are not as deep as many plasmas.

**The Bottom Line:** Expected to dominate at sizes below 50 inches as prices fall sharply and technology dramatically improves.

### DIGITAL LIGHT PROCESSING

**The Good:** Giant high-definition screens at the most affordable prices.

**The Bad:** Not thin enough to

hang on the wall; some viewers distracted by color effects of single-chip, digital-light-processing technology.

**The Bottom Line:** Most bang for the buck in homes with plenty of space.

### HOME THEATER PROJECTORS

**The Good:** Duplicates true moviegoing experience, with projection sizes larger than 100 inches.

**The Bad:** May require professional installation; don't come with TV tuners; pricey, with high replacement-bulb cost.

**The Bottom Line:** Better suited for occasional use.

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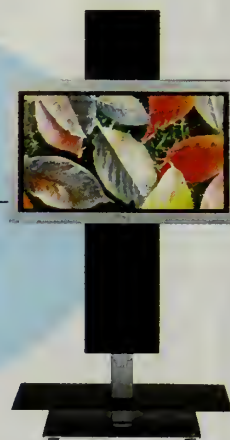
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# When the Wall Won't Do



The \$12,500 Cambridge Hideaway Media Center is perfect for those who don't want the TV to always be the focus of a room. The shelf swivels to reveal a bookcase



Mobelform's \$5,890 Periscope handles TVs with LCD or plasma screens of up to 46 inches. Users can change the viewing angle up, down, or around the base with a remote control

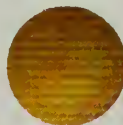
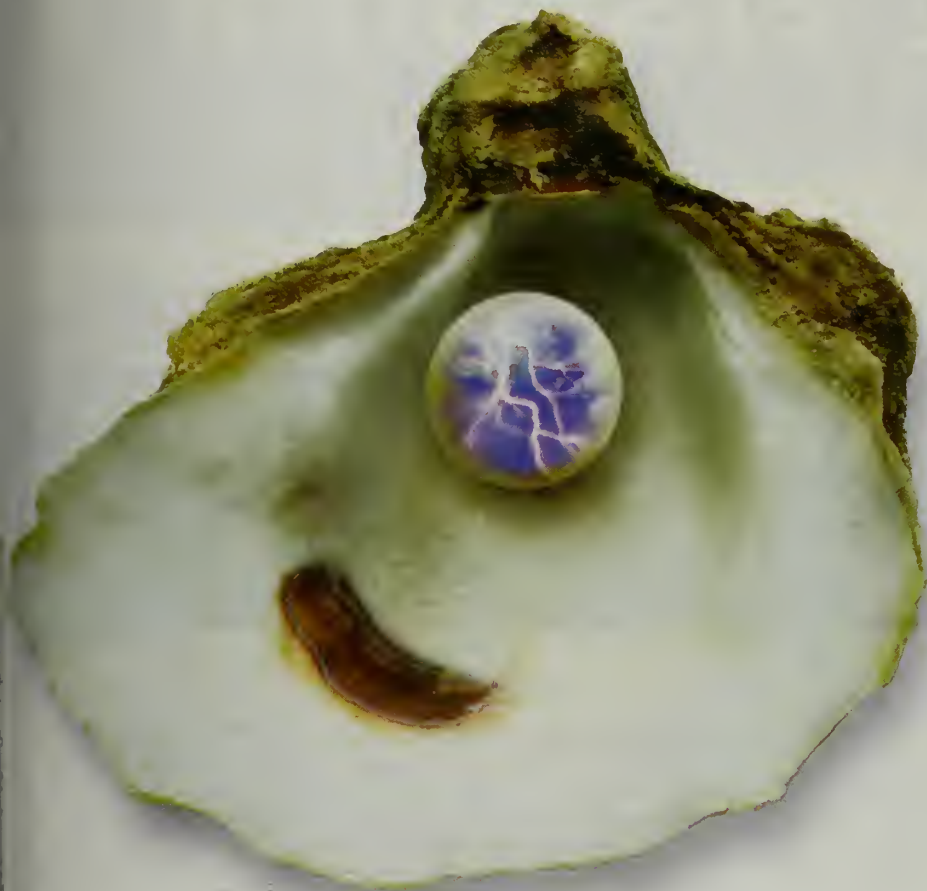
**WHEN FLAT-SCREEN** televisions were going for \$10,000 apiece, owners proudly displayed them on their walls. Now that they're more common, people once again want their TVs to blend into their home furnishings. In place of the familiar old armoires, you'll find platforms, consoles, and cabinets—what the industry calls “cases”—that gracefully integrate with their surroundings yet still accommodate the large TV screens along with all the extra boxes for DVDs, cable, and the like.

The best of these cases are gorgeous pieces of furniture that may cost three times the price of the TV. Some models conceal the screen when it's not in use. Called pop-ups, they contain a mechanical lift that rises from within the cabinet at the push of a button and brings the TV to the right height for viewing. With Martinsville (Va.)-based Hooker Furniture's \$3,500 cherry Preston Ridge Collection console, even when the flat screen is in the down position, there is still space enough inside the cabinet to hold components. The piece can accommodate a 50-inch TV without speakers or a 44-inch model with.

The \$12,500 Cambridge Hideaway Media Center from Century Furniture of Hickory, N.C., would be a great prop in a murder mystery. When the TV is in view, it looks like a traditional wooden cabinet. But push on the TV shelf and—presto! change-o!—it swivels around like a lazy Susan to reveal a bookcase on the other side. A tiny infrared eye mounted on the front lets you hide home theater components behind wood doors and still use your remote control.

For TV buyers who want to show off their new toy, the Mediacentre from Mobelform of Dania Beach, Fla., has two glass shelves mounted on an eight-foot-high cherry panel that seem to levitate underneath the flat screen. The unit retails for just under \$8,500. If you prefer something smaller and sleeker, Mobelform's \$5,890 Periscope features a glass monolith on which you suspend up to a 46-inch TV. A remote control lets you move the TV up, down, or around the base. —By Andrew Park

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# Video Players: HD-DVD vs. Blu-ray



**SONY BDP-S1  
BLU-RAY DISC PLAYER:**  
The company is betting  
big on Blu-ray.  
Its PlayStation 3  
(due out in November)  
will double as a  
Blu-ray player



**THE RESOLUTION ON** DVD players is light-years behind what the latest crop of high-definition televisions can do. The next-generation video formats, Blu-ray Disc and HD-DVD, have 5 to 10 times the capacity of old DVDs. Ready to switch? Here's the catch: Blu-ray won't work in HD-DVD players and vice versa. Manufacturers have hinted that future players could show both, but for now you'll have to choose sides.

**CONTENT** Four of the seven major Hollywood studios support the Blu-ray format exclusively, while only one, Universal, has taken HD-DVD's side. (Warner Bros. and Paramount work with both.) Blu-ray discs hold a maximum of 50 gigabytes, HD-DVD, just 30 gigabytes. Advantage: Blu-ray.

**PRICE** Blu-ray players hitting the market, such as Sony's BDP-S1 (\$999), are twice as expensive as entry-level HD-DVD models. (All prices are suggested retail except where otherwise noted.) The only Toshiba model with 1080p output, which all the Blu-ray players have, is also priced at \$999, however. Toshiba says it will be cheaper to manufacture HD-DVDs than Blu-ray discs, but Blu-ray folks dispute that. Advantage: HD-DVD.

**HEAD START** When a new technology first hits the market, you can be sure it will have bugs. Case in point: Samsung's BD-P1000 (\$750 from online discounters), which shipped with a bad chip that marred its image quality. (Samsung says it is fixing the problem.) Meanwhile, HD-DVD champion Toshiba is already unveiling its second round of players, the HD-A2 (\$499) and HD-XA2 (\$999, available in December), sporting sleeker profiles, faster startup times, and better remote controls. Advantage: HD-DVD.

**GAMING** It's not all about movies. Sony's PlayStation 3 (\$499, available in mid-November) will double as a Blu-ray player. Not to be outdone, Microsoft is offering an add-on HD-DVD player for its Xbox console (\$200, available in mid-November). If the PS3 is a hit, it will help Blu-ray. Advantage: Blu-ray.

—By Andrew Park

# FT Innovate 2006

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Topics for discussion:

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What does open innovation mean in practice? How do you overcome organisational boundaries to openness? How do you source and engage external talent into the innovation process? Does internal IP protection stifle the innovation process?

#### INNOVATION LEADERSHIP AND THE RISE OF THE CHIEF INNOVATION OFFICER

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No FT, no comment.



# Music: Unwired for Sound



**The \$999 Sonos ZonePlayer streams to your stereo with or without a computer. The system syncs music throughout the house, or can send different playlists to different rooms simultaneously**



**The \$249 Squeezebox from Slim Devices comes with everything needed to connect your home Wi-Fi network to your stereo, and adds access to Rhapsody and Pandora.com**

**IF YOU'RE AN** old school/new school music consumer, chances are you have an iPod or other digital music player and a still-great-sounding stereo system that you bought two or three presidents ago. Ditch the stereo, and you limit your music to the confines of your PC and portable player, neither of which are ideal when you want to fill the living room—or the house—with music. Sure, you can move your tunes by snaking cables around the house. But there are simpler solutions.

We looked at six systems. The most elegant and easiest to install is the \$999 Sonos ZP80 system. The ZonePlayer connects to your Internet router. Put a second unit pretty much anywhere in the house and connect it to a stereo or to powered speakers. Push two buttons and they set up their own wireless network for streaming music from the playlists on your Mac or PC. The system syncs music throughout the house or can simultaneously send different songs to different rooms.

The true beauty of Sonos' system is that you do not need to hook it up to a PC. The wireless controller lets you connect directly to the Rhapsody online music subscription service and Internet radio stations. If you go the PC route, it supports nearly every type of digital music file you've ever heard of, even iTunes playlists (but not songs purchased from the iTunes Store because of copy protection; if your music library is mostly songs bought on iTunes, use Apple's \$129 AirPort Express or Logitech's \$250 Wireless DJ Music System).

Two other favorites: the \$399 Soundbridge Radio from Roku Labs connects to your Wi-Fi network and plays your digital music files through its own speakers. It also gives easy access to streaming online radio stations. Slim Devices' \$249 Squeezebox also connects to your home network and gives access to Rhapsody, and to Pandora.com, which generates personal playlists. It has every connection you will need for your stereo or standalone speakers and handles all major sound-file formats, except, of course, songs purchased from iTunes.

—By Arik Hesseldahl



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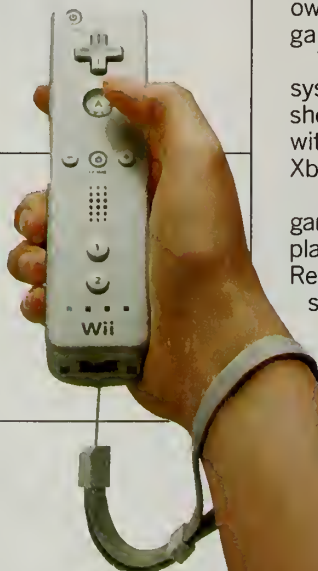


# Games: Console Wars



Nintendo's DS Lite system has become the king of portables, thanks to innovative software such as *Big Brain Academy*, which boasts a host of mind-sharpening games

The radical new controller that comes with Nintendo's Wii console may change the way people play games



**FOR MANY KIDS**, the holiday season just wouldn't be the same without wizards, warriors, and wide receivers dominating the big screen. You'll need to do plenty of strategizing of your own well before then to make sure everyone ends up with the game system they want.

Two versions of Sony's PlayStation 3, an entry-level \$499 system and higher-end \$599 one, will hit North American shelves on Nov. 17, and Nintendo will follow two days later with its \$250 Wii. They will compete with Microsoft's \$399 Xbox 360, which has been on the market about a year.

First you need to decide whether you want cutting-edge games, more online action, or a completely different way of playing. Each console offers a clear point of differentiation. Reigning champion Sony aims to expand beyond its millions-strong base of hard-core gamers by pitching the powerful PS3 as a living room entertainment system. It comes loaded with a high-definition Blu-ray DVD player. The system even offers the ability to view photos and, with a high-speed Internet connection, browse and shop on the Web.

After more than a year on the market, Microsoft will have some of the best-looking games and more titles than Sony and Nintendo combined. Developers also are planning titles that users can download and play from the Xbox Live online marketplace.

Although many of its games still look good,



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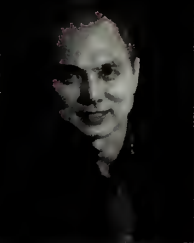
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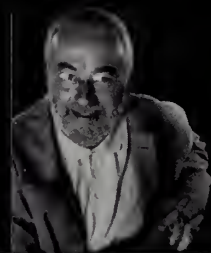
**Sir Christopher Frayling**

An acclaimed historian. Also the rector and professor of Royal College of Art in London who established pioneering postgraduate courses in the history of design with the Victoria & Albert Museum (V&A).



**Bill Moggridge**

Co-founder of IDEO and a respected industrial designer, responsible for creating and pioneering Interaction Design as a mainstream discipline.



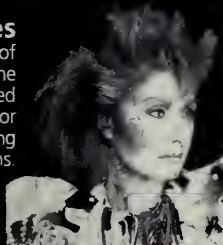
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Same controller, different console: Sony's PlayStation 3 will be the most powerful system on the planet, but can it keep Microsoft and Nintendo at bay?

## BusinessWeek online

For more on buying HDTVs, game consoles, and music players, go to [businessweek.com/extras](http://businessweek.com/extras). This week, we devote our entire TV show, *BusinessWeek Weekend*, to the Tech Buying Guide. Check your local listings or go to [businessweekweekend.com](http://businessweekweekend.com) to watch.



Nintendo's Wii will follow in the mold of the company's hit DS Lite, a handheld system, relying less on cutting-edge graphics and more on user-friendly features and family-fun games to attract people who do not traditionally play video games. Rather than getting into a direct slugfest with Sony and Microsoft, Nintendo's engineers came up with the idea of using a remote controller to make the games masterfully interactive. A wireless receiver attaches to the set and picks up commands from the remote, which uses a gyrometer and other built-in sensors to make the games more realistic than ever—even in those with cartoon-like graphics.

With *Wii Sports*, a game bundle that will be included with the purchase, you can work up a sweat swinging the controller like a bat while playing baseball. In the popular *Zelda* game, the controller becomes a fishing rod you could cast and reel. There are authentic sounds to boot.

As with all game player introductions, the new consoles will be in short supply. Sony recently announced that a shortage of the whizzy Blu-ray high-definition DVD drives it will use in the PS3 will reduce the number of available units to just 600,000, limited to the U.S. and Japan. Retailers are expected to have fewer than a dozen units per location, so you'd better start camping out now if you're determined to get one.

—By Cliff Edwards



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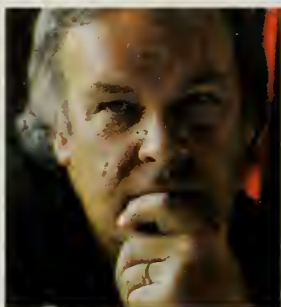
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BY ROBERT PARKER

## Dr. Zin and His Geriatric Vines

**BY EDUCATION AND TRAINING**, Larry Turley is an emergency-room doctor, but nowadays he is the world's leading practitioner of zinfandel. Plantings in California go back to the 19th century, and Turley (below, left) seeks grapes from old vines; they produce less fruit but more intense flavors. Winemaker Ehren Jordan (right) turns these grapes into wonderful wines. The surest way to get them is from the winery (805 434-1030; turleywinecellars.com). Here are some current and upcoming releases, all zinfandels from the 2004 vintage.

### Old Vines

**91 points.** This 1,000-case blend of different vineyards' lots is one of the estate's best buys. Aromas of plums, licorice, truffles, herbs, and briary black fruits are followed by a soft, plump, voluptuously textured zin to consume over the next three to four years. \$25

### Duarte Vineyard

**92 points.** There are usually fewer than 500 cases of this effort, which generally reveals southern Rhône-like garrigue—earthy, herbal characteristics—along with plenty of soil overtones, fresh black cherries, and a spicy, heady finish. \$32

### Pesenti Vineyard

**92 points.** From Paso Robles' limestone soils, the Pesenti Vineyard zin could pass for a Grenache-based southern Rhône. It has striking minerality, pepper, and kirsch liqueur-like notes. Full bodied but remarkably fresh, it should drink well for a decade. \$35

### Turley Estate

**91 points.** This wine reveals aromas of seaweed wrapper (nori) intermixed with jammy cherries, loamy soil, pepper, and garrigue characteristics. With wonderful sweetness and richness (and one of the lowest alcohol contents of these zins, just 14.9%), it will provide plenty of pleasure over the next four to five years. \$38



### Grist Vineyard

**94 points.** From rocky volcanic mountaintop soils, Grist Vineyard is always a whopper in terms of alcohol (15.8% in 2004). The deep ruby/purple-colored, Châteauneuf du Pape-like wine boasts a sensational perfume of raspberry jam, scorched earth, pepper, and garrigue. Full bodied with an amazing texture and a voluptuous mid-palate and blockbuster finish, this is zinfandel at its finest. Enjoy it over the next five to seven years. \$40

### Vineyard 101

**95 points.** This blockbuster, compelling is no shy wine, at 16.3% alcohol. It boasts an inky purple color in addition to fabulous ripeness, great intensity, a remarkable, full-bodied style, plenty of peppery black and cherry fruit, huge body, and a succor that comes across like a great Pomerol of Bordeaux. It should evolve for seven to ten years. \$42

### Hayne Vineyard

**95 points.** With 16.3% alcohol, this is one of Turley's two or three most prodigious zinfandels. A dense purple color is accompanied by aromas of white flower, black raspberries, blackberries, cassis, melted licorice, and pepper. Huge, rich, and concentrated, it is a testament to the greatness of zinfandel from a vineyard planted by Italian immigrants in 1904. It should drink well for at least a decade. \$75.

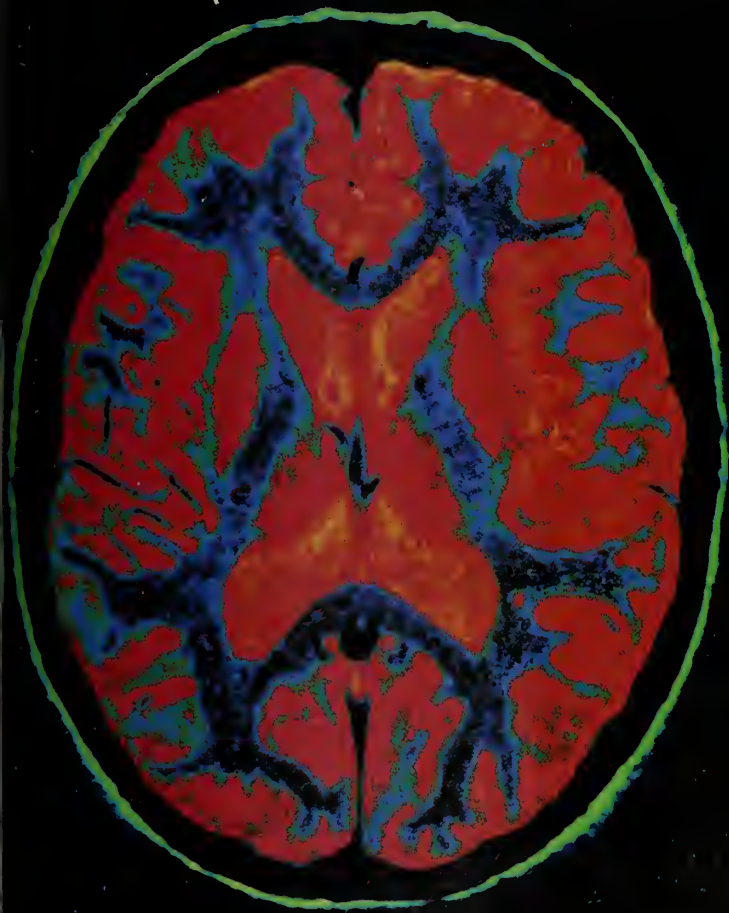
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Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to [businessweek.com](http://businessweek.com)

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BY GENE G. MARCIAL

**LEGG MASON IS DOWN FOR NOW—BUT MAYBE NOT FOR LONG.**

**WHY INVESTORS ARE DISTRESSED ABOUT PRESSTEK.**

**SONUS PHARMACEUTICALS IS BUOYED BY NEW CANCER DRUG**

## A Legg Up Soon?

**W**HEN LEGG MASON (LM), the sixth-largest U.S. asset manager, plunged from 105 to 87 a share on Oct. 11, Steven Rogé of Rogé Partners Fund couldn't believe his luck. He had been waiting to buy. Legg Mason's disclosure that third-quarter earnings missed estimates gave Rogé his chance. It's still at 87.35. The firm's shift to lower-fee fixed-income assets and an unexpected \$12 million distribution expense cut into profits. Most analysts downgraded the stock, but Rogé was unfazed: Despite Legg Mason's 10-year record of 23% annualized profit growth, he notes, its stock sells at a discount to peers, with a market cap of only \$11.7 billion. Such firms are typically valued at 2% of assets under management, he says. In Legg Mason's case, 2% of \$890 billion would be \$18 billion. Thus, the stock is a "wise buy," he argues. In late 2005, Legg swapped its brokerage and capital markets business for Citigroup's \$400 million asset-management unit, doubling its holdings. The integration of Citi properties is creating disruptions, but the makeover will add to earnings and increase Legg's scale and breadth, says Roger Smith of investment manager Fox-Pitt Kelton, who rates the stock "outperform." Rogé figures Legg Mason will earn \$6 a share for the year ending Mar. 31 vs. analysts' consensus estimate of just \$4.86 and fiscal 2006's \$4.05. Rogé's 12-to-18-month stock price target: 120.



## Hard-Pressed At Presstek

**A**N INVESTOR GROUP at Presstek (PRST), a leader in digital laser imaging and thermal plate technologies for graphic arts, is urging the board to seek outside help to shore up its plunging stock. It has crashed from 12 in April to 5.30 on Oct. 18. Operating margins have narrowed from 7.8% in 2003 to 4.3% in 2006, and for the third quarter, Presstek expects a loss of 2¢ a share vs. a 2¢ profit a year ago. In an Oct. 6 letter to CEO Edward Marino of Presstek, John Bendall, president of Hermitage Capital, which owns more than 1 million shares, urged the board to hire an investment bank to help find ways to stop further erosion of shareholder value. The stock has declined 60% in the past year. Bendall noted a sharp drop just before Presstek issued its third-quarter profit guidance on Sept. 29. The

stock fell from 7.70 on Sept. 27 (with 241,264 shares traded) to 6.23 on Sept. 28, with 2.2 million shares. CFO Moosa E. Moosa says the board will act on the letter. A class action has been filed in U.S. District Court in New Hampshire on Oct. 12 on behalf of people who bought shares between July 27 and Sept. 29, as the stock fell 44%. Presstek calls the suit "baseless." Larry Solomon, an industry consultant, says Presstek is worth 12 based on its projected cash flow. Digital printing is "exploding," he says, and Presstek is a major player



## Sonus: Far from The Biotech Doldrums

**N**OT MANY BIOTECHS are favored by the Street, even though the broader market is riding high. But one that has attracted unusual attention is Sonus Pharmaceuticals (SNUS), whose lead product, TOCOSOL Paclitaxel, is currently in Phase 3 trials for the treatment of metastatic breast cancer, with a market potential of \$3.5 billion. Sonus' stock, up from 4.50 on Oct. 3 to 5.37 on Oct. 18, is rated a "buy" by Mark Monane of Needham, which has done banking for Sonus. His 12-month target is 10. In 2005, Germany's Schering acquired a 15% stake in Sonus for an exclusive license on TOCOSOL. Monane expects data from the trial by mid-2007 and a new-drug application at yearend 2007. Matthew Kaplan of Punk Ziegel, who also rates Sonus a "buy," says a second product, TOCOSOL Camptothecin for colorectal cancer, has been O.K.'d by the Food & Drug Administration for Phase 1 trials. He says this will advance Sonus' oncology franchise. Another bull, Vinny Jindal of ThinkEquity Partners, which also has done banking for Sonus, estimates royalties of \$203 million for TOCOSOL Paclitaxel alone in 2013. Jindal also has a 12-month price target for the stock of 10. ■



**BusinessWeek online** Gene Marcial's Inside Wall Street is posted at [businessweek.com/investor](http://businessweek.com/investor) at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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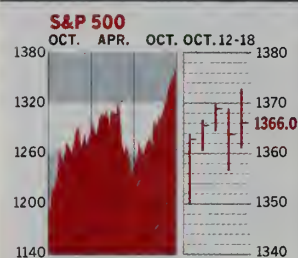
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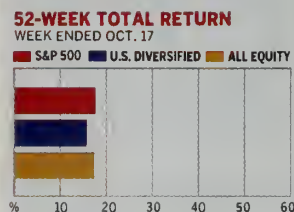
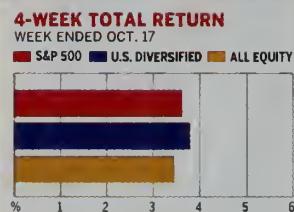


### COMMENTARY

A decline in consumer prices for September, lower crude oil prices, and positive earnings reports from IBM and Intel led the Dow to rise briefly above the 12,000 level on Oct. 18. Despite a surprising increase in housing starts for September, homebuilders had a rough time. KB Home, Pulte, and Centex were all lower on the week.

Data: Bloomberg Financial Markets, Reuters

### MUTUAL FUNDS



Data: Standard & Poor's

### U.S. MARKETS

|                       | OCT. 18  | WEEK | % CHANGE<br>YEAR TO<br>DATE | LAST 12<br>MONTHS |
|-----------------------|----------|------|-----------------------------|-------------------|
| S&P 500               | 1366.0   | 1.2  | 9.4                         | 15.9              |
| Dow Jones Industrials | 11,992.7 | 1.2  | 11.9                        | 16.6              |
| NASDAQ Composite      | 2337.2   | 1.3  | 6.0                         | 13.7              |
| S&P MidCap 400        | 782.1    | 1.6  | 6.0                         | 15.7              |
| S&P SmallCap 600      | 388.5    | 2.5  | 10.8                        | 18.2              |
| DJ Wilshire 5000      | 13,660.2 | 1.3  | 9.3                         | 16.4              |

### SECTORS

|                      | OCT. 18 | WEEK | % CHANGE<br>YEAR TO<br>DATE | LAST 12<br>MONTHS |
|----------------------|---------|------|-----------------------------|-------------------|
| BusinessWeek 50*     | 770.4   | 1.0  | 3.9                         | 9.1               |
| BW Info Tech 100**   | 421.1   | 0.9  | 10.7                        | 18.7              |
| S&P/Citigroup Growth | 633.1   | 1.2  | 6.1                         | 11.6              |
| S&P/Citigroup Value  | 730.9   | 1.2  | 12.9                        | 20.5              |
| S&P Energy           | 417.8   | 4.1  | 12.1                        | 18.0              |
| S&P Financials       | 475.5   | 0.6  | 11.5                        | 22.4              |
| S&P REIT             | 191.8   | 2.4  | 25.4                        | 33.9              |
| S&P Transportation   | 265.1   | 1.1  | 6.1                         | 20.5              |
| S&P Utilities        | 178.9   | 2.3  | 12.0                        | 15.0              |
| GSTI Internet        | 177.6   | -0.5 | -13.4                       | 1.3               |
| PSE Technology       | 850.4   | 0.9  | 1.7                         | 8.3               |

\*Mar. 19, 1999=1000 \*\*Feb. 7, 2000=1000

### GLOBAL MARKETS

|                             | OCT. 18  | WEEK | % CHANGE<br>YEAR TO<br>DATE |
|-----------------------------|----------|------|-----------------------------|
| S&P Euro Plus (U.S. Dollar) | 1812.5   | 0.4  | 19.9                        |
| London (FT-SE 100)          | 6150.4   | 1.3  | 9.5                         |
| Paris (CAC 40)              | 5361.3   | 0.9  | 13.7                        |
| Frankfurt (DAX)             | 6182.8   | 1.0  | 14.3                        |
| Tokyo (NIKKEI 225)          | 16,653.0 | 1.5  | 3.4                         |
| Hong Kong (Hang Seng)       | 18,048.1 | 1.0  | 21.3                        |
| Toronto (S&P/TSX Composite) | 11,966.0 | 3.0  | 6.2                         |
| Mexico City (IPC)           | 23,012.9 | 2.8  | 29.3                        |

### FUNDAMENTALS

|                                      | OCT. 17 | WEEK AGO |
|--------------------------------------|---------|----------|
| S&P 500 Dividend Yield               | 1.79%   | 1.81%    |
| S&P 500 P/E Ratio (Trailing 12 mos.) | 17.8    | 17.8     |
| S&P 500 P/E Ratio (Next 12 mos.)*    | 14.7    | 14.5     |
| First Call Earnings Surprise*        | 5.29%   | 8.59%    |

### TECHNICAL INDICATORS

|                                       | OCT. 17 | WEEK AGO |
|---------------------------------------|---------|----------|
| S&P 500 200-day average               | 1288.4  | 1285.8   |
| Stocks above 200-day average          | 66.0%   | 61.0%    |
| Options: Put/call ratio               | 0.83    | 0.82     |
| Insiders: Vickers NYSE Sell/buy ratio | 3.94    | 3.84     |

### BEST-PERFORMING GROUPS

|                          | LAST MONTH % |                          | LAST 12 MONTHS % |
|--------------------------|--------------|--------------------------|------------------|
| Real Estate Mgt. & Dvpt. | 20.6         | Steel                    | 109.7            |
| Auto Parts & Equip.      | 17.9         | Fertilizers & Ag. Chems. | 55.1             |
| Steel                    | 12.3         | Divsfd. Metals & Mining  | 52.9             |
| Auto Retail              | 11.7         | Agricultural Products    | 52.4             |
| Restaurants              | 11.5         | Department Stores        | 47.2             |

### WORST-PERFORMING GROUPS

|                              | LAST MONTH % |                      | LAST 12 MONTHS % |
|------------------------------|--------------|----------------------|------------------|
| Education Services           | -25.0        | Education Services   |                  |
| Health-Care Services         | -11.1        | Internet Retailers   |                  |
| Drug Chains                  | -10.2        | Homebuilding         |                  |
| Gold Mining                  | -5.8         | Internet Software    |                  |
| Health-Care Distrib. & Svcs. | -5.5         | Spclzd. Cnsmr. Serv. |                  |

### EQUITY FUND CATEGORIES

| 4-WEEK TOTAL RETURN   | %   | 52-WEEK TOTAL RETURN    | %    |
|-----------------------|-----|-------------------------|------|
| <b>LEADERS</b>        |     | <b>LEADERS</b>          |      |
| Latin America         | 8.0 | Latin America           | 45.5 |
| Small-cap Growth      | 5.0 | Precious Metals         | 41.0 |
| Small-cap Value       | 4.6 | Real Estate             | 36.6 |
| Communications        | 4.5 | Diversified Emrg. Mkts. | 33.3 |
| <b>LAGGARDS</b>       |     | <b>LAGGARDS</b>         |      |
| International Hybrid  | 2.0 | Health                  | 8.7  |
| Domestic Hybrid       | 2.2 | Large-cap Growth        | 11.1 |
| Japan                 | 2.3 | Domestic Hybrid         | 11.4 |
| Pacific/Asia ex-Japan | 2.4 | Technology              | 13.3 |

### EQUITY FUNDS

| 4-WEEK TOTAL RETURN           | %     | 52-WEEK TOTAL RETURN         | %     |
|-------------------------------|-------|------------------------------|-------|
| <b>LEADERS</b>                |       | <b>LEADERS</b>               |       |
| DireXn. Lat. Am. Bull 2X Inv. | 16.7  | Oberweis China Opport.       | 68.3  |
| American Heritage             | 14.3  | ING Russia A                 | 67.8  |
| DireXn. NASDAQ 100 Bl. 2.5X   | 12.9  | U.S. Global Invs. Gold       | 64.7  |
| DireXn. Sm. Cap Bull 2.5X     | 12.7  | U.S. Globl. Invs. Prc. Mnls. | 60.3  |
| <b>LAGGARDS</b>               |       | <b>LAGGARDS</b>              |       |
| Ameritor Investment           | -50.0 | Ameritor Investment          | -88.9 |
| DireXn. Sm. Cap Bear 2.5X     | -12.7 | American Heritage Grth.      | -40.0 |
| DireXn. NASDAQ 100 Bear 2.5X  | -11.8 | DireXn. Sm. Cap Bear 2.5X    | -37.0 |
| ProFunds UtlSh. Emrg. Mkts.   | -11.5 | ProFds. UtlSh. Sm. Cap Inv.  | -33.4 |

### INTEREST RATES

| KEY RATES                | OCT. 18 | WEEK AGO |
|--------------------------|---------|----------|
| Money Market Funds       | 4.84%   | 4.84%    |
| 90-Day Treasury Bills    | 5.09    | 5.02     |
| 2-Year Treasury Notes    | 4.84    | 4.84     |
| 10-Year Treasury Notes   | 4.76    | 4.78     |
| 30-Year Treasury Bonds   | 4.89    | 4.91     |
| 30-Year Fixed Mortgage † | 6.23    | 6.18     |

### BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

|                       | 10-YR. BOND | 30-YR. BOND |
|-----------------------|-------------|-------------|
| General Obligations   | 3.87%       | 4.00%       |
| Taxable Equivalent    | 5.53        | 6.00        |
| Insured Revenue Bonds | 3.89        | 4.00        |
| Taxable Equivalent    | 5.56        | 6.00        |

### THE WEEK AHEAD

**FOMC MEETING** Tuesday, Oct. 24, 9 a.m. EDT » The Federal Reserve's Open Market Committee begins its two-day meeting to set monetary policy. Every economist queried by Action Economics expects the Fed will maintain interest rates at 5.25%.

**EXISTING HOME SALES** Wednesday, Oct. 25, 10 a.m. EDT » Existing home sales in September probably declined to an annual rate of 6.25 million, from

6.3 million units in August. Median home prices were down from the year before in August for the first time since April, 1995.

**DURABLE GOODS ORDERS** Thursday, Oct. 26, 8:30 a.m. EDT » Durable goods orders most likely rebounded with a 1% increase. New orders were unchanged during August.

**NEW HOME SALES** Thursday, Oct. 26, 10 a.m. EDT » New home sales are forecast to have

edged higher, to an annual rate of 1.06 million, in September. Sales in August rose slightly, to a pace of 1.05 million.

**GROSS DOMESTIC PRODUCT** Friday, Oct. 27, 8:30 a.m. EDT » Third-quarter real gross domestic product probably grew at an annualized rate of 3%. The rapid decline in residential construction probably held down growth. In the second quarter, growth cooled to a pace of 2.6%.

The BusinessWeek production index stood at 284.2 for the week ended Oct. 7, a 10.3% gain from the four-week moving average, index bounced up to 284.5.

**BusinessWeek** online

For the BW50, more investment data, and the components of the production index visit [www.businessweek.com/extras](http://www.businessweek.com/extras)

# Steal a thing or two from our Playbook.

**Playbook: Best Practice Ideas** distills the central ideas of an article to give you actionable take-aways. Whether it's a story on tapping the power of the Web or pampering employees with paid sabbaticals, these graphic boxes deliver a quick snapshot of dos and don'ts and how-tos.

Look for your Playbook in BusinessWeek.

designers, inventors, and scientists, all models for companies because of failures in their careers. He's also quick

## PLAYBOOK: BEST-PRACTICE IDEAS

### Formula for Failure

Innovation's great paradox: Success—that is, true breakthroughs—usually comes through failure. To help your team get comfortable with taking risks and learning from their mistakes.

#### Formalize Forums For Failure

To keep failures and the valuable lessons they offer from getting swept under the rug, **carve out time for reflection.** GE has recently begun sharing lessons from failures by bringing together managers whose "Imagination Breakthrough" efforts are put on the shelf.

#### Move The Goalposts

Innovation requires flexibility in meeting goals, since early predictions are often little more than educated guesses. Intuit's Scott Cook even suggests that teams developing new products ignore forecasts in the early days. "For every one of our failures, we had spreadsheets that looked awesome," he says.

#### Share Personal Stories

If employees hear leaders discussing their own failures, **they'll feel more comfortable talking about their own.** But it's not just the CEO's job—front-line leaders are even more important, says Harvard Business School professor Amy Edmondson. "That person needs to be inviting, curious, and the first to say: 'I made a mistake.'"

#### Bring In Outsiders

Outsiders can **help neutralize the emotions and biases that prop up a flop.** Customers can be the most valuable. After its DNA chip failed, Corning brought pharma companies in early to test its new drug-discovery technology, Epic.

#### Prove Yourself Wrong, Not Right

The tenets of development teams: rather than evidence what you're right, **test to prove you're wrong.** Anthony seeks right?

#### Celebrating Small Wins

Managers perform systems and find failure new, and o

## PLAYBOOK: BEST-PRACTICE IDEAS

### The Pause that Refreshes

Companies that pamper veteran employees with paid sabbaticals include:

#### CHARLES SCHWAB

Four weeks at every five years of employment. Employees need supervisors' O.K. to take time off.

#### INTEL

Eight weeks at every seven years of employment. Employees also receive up to four weeks of paid vacation each year.

#### EILEEN FISHER

One week at every 10 years of employment. Employees also get \$5,000 that must be spent during their bonus vacation.

#### MCDONALD'S

Eight weeks at every 10 years of employment. Starting next year, employees will get an extra week off on the "fives," too.

#### HEWITT ASSOCIATES

One week off for every five years of employment, maxing out at three weeks. Part-timers qualify, too.

#### MORNINGSTAR

Six weeks at every four years of employment. Its trigger anniversary is among the earliest of the corporations surveyed.

**EPIC CHANGE**  
Corning's new system uses light waves to test new drugs

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BusinessWeek





Two roads diverged in a wood, and I —  
I took the one less traveled by,  
And that has made all the difference.

*from "The Road Not Taken" by Robert Frost*

Humana took its Medicare program down a different path this year and picked up 4.5 million members along the way.

**How?**

- We set up a multi-faceted distribution channel, including retail partners.
- We met people face-to-face, where they live and shop.
- We infused technology throughout the process, from enrollment to claims.

And we're still making a difference with award-winning customer service and the industry-leading SmartSummary Rx<sup>SM</sup> monthly statement for all Medicare members.

Maybe our road is right for you, too. [www.humana.com](http://www.humana.com)

**HUMANA**  
*Guidance when you need*

- Group health
- Medicare
- Individual health
- Dental and Life



## &gt;&gt;Medicare Prescription Drug Coverage

# SATISFYING A CHOOSEY CUSTOMER

**A**bout 43 million people qualify for Medicare Part D, touted as the first major improvement in 40 years of Medicare. By mid-June, 38.2 million had enrolled in some kind of prescription drug plan. The Centers for Medicare and Medicaid Services hopes to have the remaining sign-ups completed between November 15 and December 31, the next enrollment time and the annual period for enrollees to make plan changes.

**J.D. Power and Associates** surveyed almost 5,000 beneficiaries to create regional report cards of Medicare-approved Part D plans. As survey results came in, pharmacy experience surfaced as a leading factor in satisfaction for Part D beneficiaries. Separately, J.D. Power found that formularies and pharmacy networks are crucial components of employer-sponsored plans.

Now, a 28% subsidy gives employers new incentive to maintain drug coverage for their retirees in 2006 and beyond. Those retiree plans achieved higher satisfaction levels in part because retirees did not have to deal with the confusion surrounding enrollment in a Part D plan.

## LISTENING TO THE VOICE OF CUSTOMERS

Humana provides health coverage to 3.4 million Medicare Part D beneficiaries. Its Part D plans are designed on two of Humana's beliefs: a patient's first decision point in choosing a plan is based on price, and the second decision point is whether the patient's drug is covered, says William Fleming, PharmD and vice president of pharmacy and clinical integration at Humana.

**HUMANA**  
*Guidance when you need it most*

Humana offers some of the lowest premiums of Part D plans in the market. Additionally, "no one has a broader formulary than we do," Fleming says. Compared with competing formularies, Humana's requests for drug exceptions and appeals tend to be fewer most of the time, he reports.

To help Medicare beneficiaries understand Part D, Humana offers Smart-

SummaryRx, a program that updates the monthly benefits statements required by Medicare. But in addition, it offers articles individualized to the patient's health, drug purchasing tips, and a gauge that shows how near the patient is to hitting the Part D coverage gap. The summary's Rx Manager section includes the patient's regular and occasional prescriptions and refill dates

over the last year. When a patient takes this summary to an office visit, "it allows the doctor to see very quickly if the patient is compliant on prescriptions and what medications he or she is taking," Fleming says. Medicare Part D coverage is a customer experience, he adds, and Humana invests in customer satisfaction research to stay ahead of that experience.



## &gt;&gt; MEDICARE PRESCRIPTION DRUG COVERAGE

**DRUG FORMULARIES THAT DO THE JOB**  
**What makes a match for employee needs?**

Medicare Part D legislation mandates that insurance plans offer a minimum formulary that covers medications commonly taken by people age 65 and older. Less expensive, generic drugs and brand-name medications are in the list.

Clearly, Medicare Part D is not a one-size-fits-all program. Instead, employers need to discern which plans provide formularies that best match their organization. The answers to several key questions can help guide this decision:

- Does the formulary present choices among medications most commonly needed by the group?
- Do beneficiaries have a choice of plans and, within those, a wide selection of medications and payment options?
- Do the plans address how beneficiaries like to get their medications--by going to a favorite drug store and having access to the pharmacist or by minimizing pharmacy trips and using mail order for doorstep delivery? Are the preferred drug stores in the pharmacy network?
- Does the package offer protection against Part D's coverage gap, the "doughnut hole" that occurs in a "standard" plan after a beneficiary pays a \$250 deductible?

**HELPING BENEFICIARIES MAKE BEST CHOICES**  
**Families, employers can be allies for seniors**

At the close of Medicare Part D's enrollment period this spring, about 4.4 million Medicare-eligible beneficiaries had chosen not to enroll. Persons who take few or no drugs may have hesitated to sign up for Medicare Part D. However, the program provides insurance against high medication expense later, if a person's health status unexpectedly changes.

This fall, all seniors are coming up on an annual open enrollment period (just like most employees do), but the process needn't be intimidating. As seniors sort through options, families and employers can be instrumental in helping them make sound choices for their coverage in 2007.

**VALUING RETIREE HEALTH BENEFITS**  
**Drug subsidy helps keep employer-provided coverage**

As Medicare Part D was implemented, employers became eligible to receive a tax-free 28% federal subsidy if they offered their retirees prescription drug coverage at least inclusive as Medicare's "standard" prescription drug plan (PDP). Both for-profit and nonprofit companies can qualify for this support when they offer such coverage to Medicare-eligible employees and retirees.

The subsidy gives timely relief to employers after a decade of increasing health benefits costs, says Paul Dennett, vice president of health care policy, American Benefits Council. Employers are readily using this option to help pay the tab for retiree drug coverage. They can also offer "wrap-around" coverage by selecting an independent PDP that provides an enhanced benefit.

Additionally, "Medicare Part D offers an opportunity for companies to drop coverage and know that employees and retirees have a plan to go to," says Jack Hoadley, research professor at the Health Policy Institute, George Washington University.

The new Medicare program gives employers the opportunity to examine their offerings each year. And with congressional elections this fall and elections for a new president in two years, "the exact design of [Medicare Part D] will not be locked in forever," Hoadley forecasts.

**RETIREE COVERAGE AND GROWTH THAT DELIVER SOLUTIONS**

**In 2006, Health Net, Inc., covered nearly 200,000 Medicare beneficiaries through Medicare Advantage products in five states and almost 300,000 through its stand-alone drug plan in 10 states. While this market represents about 18% of its business, the company foresees extending Medicare prescription drug plans to all 50 states in 2007, gaining a national footprint in the Medicare market.**



**Health Net<sup>®</sup>**  
Medicare Programs

>> About 25% of Health Net's Medicare beneficiaries have plans subsidized by the retiree or employer. Sam Srivastava, chief Medicare officer, notes a trend of beneficiaries and employer groups wanting to have more options, accessibility, value, and more choices. "We develop new products that meet

the needs of seniors," Srivastava says. "An example is private fee for service, where beneficiaries can go to any physician or hospital as long as they accept Health Net reimbursement. Without the limitations posed by a provider, this is a very portable product ideally suited to highly mobile seniors." The plan offers

benefit designs tailored to the employer group and the retiree. "Health Net makes the whole alphabet soup of Medicare simpler," Srivastava says. "We offer a simple, affordable solution." Its goal: to respond to seniors who say, "Give us a template and a choice, but don't tell us what we need."



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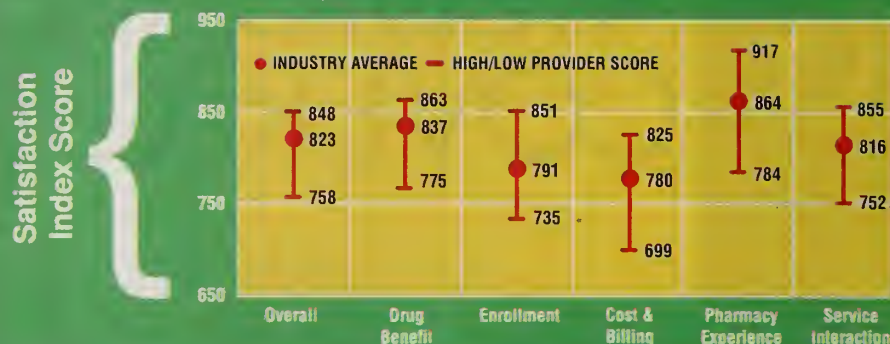
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## &gt;&gt; MEDICARE PRESCRIPTION DRUG COVERAGE

## Range of Satisfaction Performance



Source: J.D. Power and Associates

>> Medicare Part D receives high scores in satisfaction. If the gap between high and low performance scores is narrow, differentiation in the factor is slight. Where the gap is wide and the factor is important to the beneficiary, the person can better differentiate between plans to find one likely to satisfy.

## PLEASED PATIENTS

## Overall, Medicare Part D ranks well on satisfaction

J.D. POWER  
AND ASSOCIATES

Beneficiaries across the country reported a high level of satisfaction with their Medicare Part D plans, giving an overall score of 823 points out of 1,000. So reports the J.D. Power and Associates 2006 Medicare Part D Beneficiary Satisfaction Study. Among the 13 industries surveyed by J.D. Power, Medicare Part D scored among the highest in overall satisfaction.

All Medicare Part D beneficiaries will encounter an open enrollment period from November 15 through December 31, the only chance for seniors enrolling for the first time or changing plans for 2007. If they are enrolled and take no action during this period, their 2006 plan rolls over for 2007.

Survey respondents identified leading factors central to their satisfaction. The ranking gives a real-life ruler for evaluating a plan by the likelihood that it will satisfy the patient.

## 1. Drug benefit

This factor, defined as the formulary, quantity of pills that can be provided at one time, network of pharmacies, and explanation of benefits statements sent to the beneficiary, is responsible for nearly half of the customer experience. A formulary that gave an extensive list of covered medications achieved high satisfaction among beneficiaries. Patients were also more likely to stay satisfied and to stay in the plan when such a formulary was available.

## 2. Enrollment, and cost and billing

Of equal ranking were enrollment and cost and billing.

Beneficiaries felt the highest satisfaction when their plan confirmed enrollment within seven days and delivered a prescription card within 14 days. About half of seniors found enrollment very confusing, but some plans have found ways to make it less difficult.

A plan's cost and billing structure includes premiums, deductibles, out-of-pocket costs, and coverage gaps. Plans that described clearly the cost structure of Part D coverage brought the greatest satisfaction. A key factor: avoidance of confusion.

## 3. Pharmacy experience

Plans that provided an extensive pharmacy network and enabled beneficiaries to keep getting medications at their preferred pharmacy achieved a higher-than-average satisfaction rating. If the beneficiary has to change pharmacies to the plan's network, satisfaction may suffer. Additionally, some beneficiaries prefer to have face-to-face access to a pharmacist, but mail order may save money.

## WEBSITES TO WATCH

Health Net, Inc. .... [www.abetterdecision.com](http://www.abetterdecision.com)  
 Humana ..... [www.humana-medicare.com](http://www.humana-medicare.com)  
 J.D. Power and Associates ..... [www.jdpower.com](http://www.jdpower.com)  
 Help .... <http://www.medicare.gov/contacts/static/allstatecontacts.asp>

## 4. Service interaction

The quickness and thoroughness in a plan's response to a senior patient calls initially with a question were essential to customer satisfaction.

While there clearly were problems in the initiation of Medicare Part D, its strong overall satisfaction score is an achievement. To maintain this level of beneficiary contentment to continue, employers and human resource directors need to know the intricacies of Part D coverage, their enrollee group, and retiree needs. Meeting the needs with plan options and clear yet comprehensive information and stepwise procedures will not only yield the most for the beneficiary. It will minimize frustration and, ultimately, deliver medication support to a population deserving of the best. ●

This section was written by Colleen M. Sauber, a freelance writer based in Minneapolis. Design by The Mighty Design Shop.

For more information on Special Advertising Sections please contact Stacy Sass McNulty, director, worldwide special advertising sections, at: [stacy\\_sass-mcnulty@businessweek.com](mailto:stacy_sass-mcnulty@businessweek.com)



# Company Index

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# Rescued by the Gridiron

**THE BLIND SIDE** Evolution of a Game

By Michael Lewis; Norton; 299pp; \$24.95

Among pro football aficionados, the players who count the most are running backs, receivers, and quarterbacks. These are the “skill position” stars who make the acrobatic plays and get most of the postgame glory. But inside the front offices of the National Football League, another position commands equal

respect: offensive left tackle.

Left tackles generally are less photogenic than their more celebrated teammates. They’re big and wide, and sometimes their bellies jiggle. (An offensive lineman under 330 pounds is considered scrawny.) Yet players at few positions are more crucial to the success of an NFL team. Just ask the quarterbacks, whose blind sides get protected by left tackles.

In *The Blind Side: Evolution of a Game*, Michael Lewis offers a penetrating tale of how the once-overlooked position has won a lofty status. Skillfully melding striking insights with generally solid reporting and storytelling, the author of *Moneyball* and *Liar’s Poker* relates how that change was unwittingly aided by coaching whizzes Bill Walsh and Bill Parcells and the sport’s all-time most feared pass rusher, Lawrence Taylor. With others, they unleashed market forces that created a new group of multimillionaires—by the 2005 season, the left tackle would be paid more than anyone on the field except the quarterback. They also reordered recruiting priorities for every college football coach.

The search for the next great left tackle can lead almost anywhere, as Lewis poignantly illustrates. At its core, this book is an account of perhaps the unlikely left tackle of all: a six-foot-five, 344-pound young African American with virtually no football experience, rescued from the mean streets of inner-city Memphis. Michael Oher barely knew his father, who died when the lad was a teenager. His crack-addicted mother, who spent her public assistance checks on fixes, was unable to care for him and his dozen siblings and half-siblings. He wandered aimlessly through the public school system, missing months of class at a time.

In 2002, at age 16, Oher (pronounced “Oar”) arrived on the doorstep of Briarcrest Christian School, an overwhelmingly white, highly selective private school. An adult friend with whom he was living took him there in hopes he would be admitted. Administrators had never faced anyone quite like Oher, whose childhood traumas were evident in everything from his perpetual downward gaze to

his reluctance to speak. “He seemed completely intimidated by authority. Almost nonverbal,” noted the school’s principal.

With many good reasons to say no to Oher—including startling grade point average of 0.6—Briarcrest Christian yes. And so began the transformation of a lost child in many white teachers, parents, classmates, and, above all, college football coaches took an intense interest.

Oher’s salvation was his talent for sports, writes Lewis: someone so big, he had amazing coordination and grace was a natural, excelling at any game he tried, and soon he was the star of the football team. By 2004, he was among the most prized college football prospects in the U.S., one who

big-time programs were courting nonstop.

Undeniably, Oher owed his new life to a committed group of white, mostly wealthy benefactors including Sean and Leigh Anne Tuohy, who became his legal guardians; Hugh Freeze, the Briarcrest football coach and a host of tutors and teachers. While acknowledging their good deeds, Lewis explores, in all their complexity, the motives of these new FOM (Friends of Michael). Not simple in Oher’s life. Some of the favors extended to the young man appear to be repaid, if unintentionally. For instance, Oher ended up playing football at the University of Mississippi, where the Tuohys were alumni rabid fans and, surprise, Freeze became the new assistant coach.

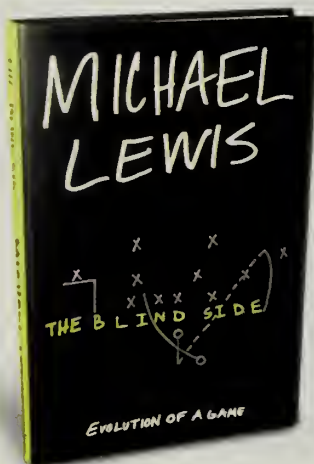
## How a traumatized kid became a very big man on campus

At times, Lewis falters. The book is noticeably easy on the halls of ivy that offered him athletic scholarships though we were aware of his considerable academic shortcomings. And unclear exactly which colleges made such offers. Lewis writes that by the opening of the 2004 high school football season, “the only major football school that hadn’t offered [Oher] a full

scholarship was Penn State.” I wondered if that could be true of the prestigious University of California at Berkeley, which finished No. 9 in the final Associated Press Top 25 college football poll his senior year. It isn’t, according to a Cal-Berkeley spokesman. Lewis, in an e-mail, told this reviewer he was referring only to “the perennials—like Oklahoma, Alabama, Florida, Florida State...and a half dozen others.”

Yet such nits hardly detract from Lewis’ overall report and analysis. His book is an engrossing, if anguished, story of serendipity and salvation. And as long as Michael Oher is shoulder pads, it’s a story without an end. ■

—By Mark Hyman





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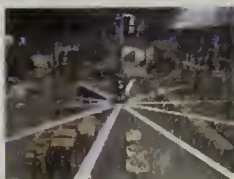
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## IdeasOutsideShot

BY VICTORIA MARKHAM

# America's Supersized Footprint

My daughter and I watched the U.S. Census Bureau Population Clock tick its way, second by second, to the magical 300 million mark this week. At the historic moment early Tuesday, she asked: "Why does that matter?" The answer may be more disturbing than she—or any of us—knows, because the U.S. is a world leader not only in gross domestic product,

per-capita income, innovative technologies, and many health and educational standards, but also in a more dubious measure: our environmental footprint. And that can only become more worrisome as our numbers increase.

The U.S. population has the largest per capita environmental imprint in the world, with greater impact on many of the planet's resources and ecosystems than any other nation on earth. Indeed, while we represent just 1/20th of the global population, we consume disproportionately higher amounts—at least one-fourth—of practically every natural resource. Meanwhile, the U.S. is the only industrialized country in the world still experiencing significant population growth. This combination of relatively rapid population increase and hefty rates of resource consumption makes for a volatile mix.

To be sure, a large population doesn't necessarily equate to equally large environmental consequences. A lot depends on the choices that people make about the way their land is developed (say, "cluster" mixed-use building vs. more spread out "sprawl" development), the types of transportation or energy they use, and the methods employed in local industries or agriculture. And nature has an amazing capacity to bounce back from human assault, often saving us from lasting negative environmental impacts.

But current U.S. population trends, such as rapid growth or density in environmentally vulnerable coastal areas, coupled with high consumption rates of polluting resources—all over a relatively short period of time—are pushing us past some ecological limits. For example, America's current high levels of fossil-fuel burning create carbon dioxide emissions that accelerate climate change; rapid land development costs us 3,000 acres of prime farmland loss daily; and ground and airborne pollutants have made more than 40% of America's rivers and lakes unsuitable for fishing or swimming.

Although we have plenty of empty land in the U.S., that is not the best indicator of how many people we can actually support. The U.S. is now primarily a "metro-nation,"

with four out of five Americans living in suburban and metropolitan areas. This suburbanization has resulted in sprawl development being the nation's predominant form of land-use change. That has brought a marked increase in the number of houses (and their average size, the acres around them, and the resources needed to build, heat, and cool them) and in all the vehicles it takes to get to and from them. That's a big reason transportation has become the nation's fastest-growing, energy-use sector—driving the increased fossil fuel use that has made us the world's largest CO<sub>2</sub> emitter. With just 5% of the world's people, we're responsible for 25% of global CO<sub>2</sub> emissions.

As we reach the 300 million milestone, the mirror reveals we've become a super nation, with a supersized appetite for land, water, energy, and resource consumption. "More of more" is the rule: more people than ever before, more natural resources being utilized to support everyday life, and increasingly, more damage to the natural systems that support us.

But with America's dubious distinction as the most disproportionate user of global resources should come an equally weighty responsibility in dealing with the consequences. Starting here at home, we need to make environmental sustainability a national priority and American consumers need more readily

available environmentally-sound choices that they can afford. In our globalized world, the U.S. should demonstrate renewed international leadership in reducing greenhouse emissions and in supporting international family planning. These measures can help restore some balance between people and the environment in the nation and worldwide.

Expanding our nation's consciousness of our per capita environmental impact won't be easy. But maybe that's the growth that America—a nation of 300 million people and counting—really needs. ■

**With just 5%  
of the world's  
people, the  
U.S. uses at  
least 25% of  
nearly every  
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*Victoria Markham is director of the Center for Environmental Population.*

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# Ideas **The Welch Way**

BY JACK AND SUZY WELCH

## Dialing for Growth

**My 17-year-old business has grown into a solid, profitable operation. Where do people like me go for advice on moving to the next level of growth? Most books seem to focus on startups and large businesses. We're neither, but we have a great business model and a real fire to create something special.**

—Jerry Giampaglia, Mahwah, N.J.

One answer to your question is as close as your phone, although what we are about to suggest may seem awkward, even outlandish. Pick up your phone, call companies where you see exciting management breakthroughs—and ask if you can watch them in action.

We bet the answer will be: “Sure, let’s set it up.”

Counterintuitive? Maybe, but we’ve seen that dynamic play out over and over in the past several years. Indeed, we’ve found that most people are bursting to talk about their successes with anyone who asks, regardless of the inquiring company’s size, public profile, or market might. In other words, you don’t have to be a big boss or the employee of a famous company to get doors to open. You just need to have the guts to ask for advice.

We’re not suggesting, of course, that you contact competitors. But there is a whole world of other companies out there using management practices that could really improve your performance. Armies of companies, for instance, learned about lean manufacturing from Toyota, which proudly opened up its factories like living classrooms. Wal-Mart has likewise shown many visiting companies how to use information technology to fine-tune product availability and better meet customer needs.

But don’t just think about calling the usual suspects for advice. Hundreds of companies, if not thousands, are using the Six Sigma quality program, some of them in interesting new ways. The same is true for many up-and-coming management concepts, such as the customer loyalty measurement called the “net promoter score.” The point is: Teachers are everywhere; you just have to find them. And that’s not hard. The media continuously highlight success stories, often putting the contact point right in front of you.

A red flag here, however. Visiting companies to watch them in action can be great, but the exercise is pointless unless

your own people are ready to embrace outside ideas. I don’t, some adjustment to your culture is probably needed. To do that, you’ve got to kill any not-invented-here syndrome floating around your organization and replace it with new value of open-mindedness. You can jump-start the process by using praise, money, and promotions to celebrate employees who find outside ideas and bring them back. Before you know it, you’ll find yourself deluged with good ideas from every quarter.

Bringing the outside in can be daunting, especially for a successful company like yours, but don’t let the challenge deter you. If you really want to get to the next level in your business, look everywhere for companies using ideas that can open up your eyes, expand your mind, and change your ways. Then pick up the phone and call. Someone will answer.

**Why is there an age, 60-65, when people are required to retire?**

—Anonymous

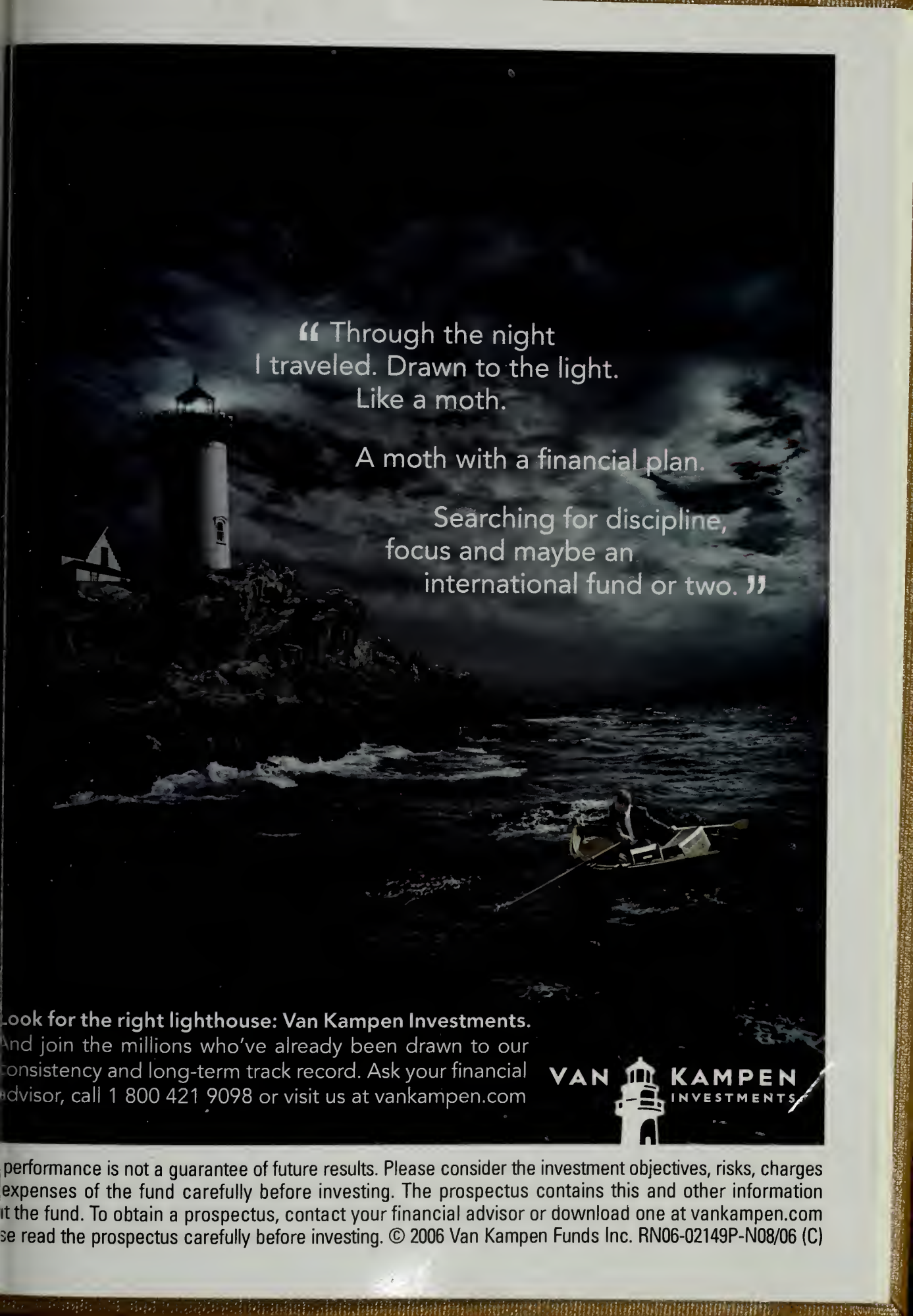
There are as many answers to this question as there are people, since each retirement case has to do with the person, job, company, country, and so on. But for the sake of discussion, we’ll assume your question pertains to retirement within the S&P 500 world of big corporations.

In which case there are two answers, because corporations generally have two categories of employees. First there are the specialists—individuals with unique, accumulated knowledge. Given the long and productive lives people live today, it hardly makes business sense to bid farewell to valuable employees at some arbitrary age. We say let them decide to work or not, as long as they keep contributing.

But we’d make the opposite case for the second category: leaders. Why? Because companies need vitality and change. Stay static, and they petrify. Often that’s what happens when people in the top layers hang around for too long. Great people in their 30s and 40s don’t want to wait 10 years for their shot. They want to invigorate companies with new ideas and shake things up now, and organizations should let them. With a change of leadership, fresh air pours in the window and new energy puts extra spark in the place.

That’s why, generally speaking, managers in their 60s should take their good economics, well earned over decades, and move on to exciting, and different, new futures. They should be giving their companies the same in return. ■

*Jack and Suzy Welch look forward to answering your question about business, company, or career challenges. Please e-mail them at [thewelchway@businessweek.com](mailto:thewelchway@businessweek.com). For their weekly podcast, go to [www.businessweek.com/search/podcasting.htm](http://www.businessweek.com/search/podcasting.htm)*



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